BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of

	)	
Application of SBC Communications Inc.,	)	
Pacific Bell Telephone Company, and	)	WC Docket No. 02-306
Southwestern Bell Communications	)	
Services, Inc. for Provision of In-Region,	)	
InterLATA Services in California	)	
	)	
	)	

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COMMENTS OF AT&T CORP.

Pursuant to the Commission's Public Notice, AT&T Corp. ("AT&T") respectfully submits these comments in opposition to the application of SBC Communications, Inc., ("SBC"), Pacific Bell Telephone Company ("Pacific"), and Southwestern Bell Communications Services, Inc. ("SBCS"), for authorization to provide in-region, interLATA services in California.

INTRODUCTION AND SUMMARY

Pacific's 271 application for California is unique, but not in the ways that Pacific portrays. It is true, for example, that the proceedings before the California Public Utilities Commission ("CPUC") have been protracted, but that is because – as the state commission and others have found – Pacific itself has engaged in "delaying tactics" that obstructed the state's efforts to set TELRIC-compliant rates and to evaluate whether Pacific had overhauled its discriminatory systems and processes to the point where they could be deemed to comply with Pacific's market-opening obligations.

Pacific also misrepresents the end result of the state proceedings to date. Pacific has not persuaded state regulators that it has fully implemented all of its checklist duties, or that its entry into the interLATA services market is in the public interest. Rather, Pacific's California application is unique in that it is the first to reach the Commission with findings from the state commission that the applicant has not satisfied two of the fourteen checklist items, and that interLATA authorization at this time would not be in the public interest. And as set forth in these comments, there is more recent evidence of extraordinary anticompetitive conduct on Pacific's part that not only underscores the CPUC's concerns about checklist compliance and the public interest, but precludes any finding that Pacific will comply with its obligations under Section 272.

Far from providing a ringing endorsement of Pacific's application, the CPUC has concluded only that Pacific has made "less than complete progress" toward meeting its market-opening obligations.[1] The CPUC squarely finds noncompliance with two checklist items, Local Number Portability and Resale.[2] The CPUC also finds that "[l]ocal telephone competition in California exists in the technical and quantitative data; but it has yet to find its way into the residences of the majority of California ratepayers."[3] Furthermore, "the record does not support our making the determinations that Pacific has manifested no anticompetitive behavior, has established no improper cross-subsidization, or poses no substantial possibility of harm to the competitive intrastate interexchange telecommunications markets."[4] As a result, the CPUC concludes that "we cannot state unequivocally

[1] Decision Granting Pacific Bell Telephone Company's Renewed Motion For An Order That It Has Substantially Of The Telecommunications Act Of 1996 And Denying That It Has Satisfied § 5 709.2 Of The Public Utilities Code And Has Not Satisfied The Requirements Of The 14-Point Checklist In § 271, CPUC Decision 02-09-050, at 268 (September 19, 2002) ("*CPUC 2002 271 Decision*").

[2] *Id.* at 198-201, 215-221.

[3] *Id,* at 4.

[4] *Id.* at 3.

that we find Pacific's imminent entry into the long distance market in California will primarily enhance the public interest."[5]

The real story of Pacific's application, then, is Pacific's rush to this Commission before the CPUC could verify that all checklist obligations were met, and before persuading the CPUC that granting interLATA authorization would serve the public interest. The CPUC reached its judgment, moreover, without considering a raft of evidence of Pacific's anticompetitive conduct and of its refusal fully to implement its market-opening obligations. This evidence – much of which has emerged since the record closed in the California proceedings, and which is set forth in AT&T's comments and supporting declarations – makes abundantly clear that Pacific has not satisfied the statutory requirements for opening its markets to local competition, and that any grant of interLATA authorization now would allow Pacific quickly to leverage its local monopoly into the long distance market, and destroy the nascent prospects for local competition that the CPUC has worked so hard to develop.

First, as set forth in Part I, Pacific today lacks any concrete, specific, and enforceable legal commitment in California to provide competitors with unbundled network elements at TELRIC-compliant rates. The CPUC's decision makes quite clear, moreover, that it is Pacific that is responsible for this crucial defect. Almost three years ago, the CPUC recognized that the UNE prices originally set in 1998 were based on outdated data, much of it as old as 1994, that no longer reflected Pacific's forward-looking costs. Despite clear directives from the CPUC, however, Pacific refused to submit "cost models and cost studies" that would "allow parties" a reasonable opportunity to "understand," "replicate," and "propose changes" to them.[6] Pacific then compounded the problem with more obstructionism, such as proposing switching discounts that the CPUC described as "far

[5] *Id.* at 4.

from TELRIC compliant, fraught with mathematical errors, and substantially inadequate . . . ."[7] As a result of Pacific's "delaying tactics and insufficient showings" with regard to pricing,[8] the CPUC has been unable to establish cost-based rates for UNEs.

Notably, there is no finding by the CPUC, and no showing in Pacific's application, that the UNE rates currently in force in California are TELRIC-compliant rates. To the contrary, the only finding by the CPUC is that Pacific has yet to submit adequate cost-studies to support the establishment of cost-based rates, thus compelling the CPUC to establish interim rates that attempt to address "the most significant disparities" and to commit to establishing "permanent rates" in the future.[9] Thus, not only does Pacific come to this Commission with an application based on the unparalleled and extraordinary situation of having virtually *no* permanent UNE rates adopted with a finding that they comply with TELRIC, but also with no evidentiary basis in the state record to support a finding that even the *interim* California rates comport with TELRIC.

For this reason, Pacific is compelled to defend its UNE rates solely by analogy to the UNE rates that were effectively approved when this Commission granted Pacific's 271 application for Texas. But the Commission has never approved the use of a "benchmark" in circumstances remotely comparable to those presented here, and it is obvious that it should not do so here. The Texas rates approved over two years ago cannot be a legitimate benchmark that justifies Pacific's California rates today, because it is now clear beyond legitimate dispute that those Texas rates themselves are not TELRIC-compliant, as the Commission's Synthesis Cost Model and Pacific's own reported data independently confirm. The reality – as the Texas Public Utilities Commission itself has acknowledged – is that the previously approved Texas rates were based on data from 1996 that are

[6] *CPUC 2002 271 Decision* at 110.
[7] *Id.* at 120.
[8] *Id.*

now out of date and that, if relied upon now, would vastly overstate Pacific's 2002 costs. The Commission's prior admonition that blind acceptance of a previously approved state's rates for benchmarking purposes would improperly and "forever freeze TELRIC ratemaking" is thus fully applicable here. Indeed, the fact that California's rates correspond to the now demonstrably outdated, non-TELRIC rates in Texas is, if anything, only further evidence that Pacific has yet to establish cost-based rates in California.

Pacific has yet to fully implement its checklist obligations in other critical respects. Part II explains that, continuing a longstanding pattern of obstructing CLEC entry and driving up rivals' costs, SBC has notified CLECs that it no longer plans to honor its obligation to provide CLECs with nondiscrimatory access to combinations of network elements. Citing the Supreme Court's decision last Term in *Verizon Comm. Inc.* v. *FCC*, 122 S.Ct. 1646, 1683-87 (2002), SBC has invoked the "change of law" provisions in all of its interconnection agreements claiming that it need not and will no longer provide competitors with nondiscriminatory access to what SBC labels "new combinations" of elements. The argument is absurd, because the Supreme Court upheld this Commission's additional combinations rule, and rejected the arguments of SBC and other RBOCs that SBC now invokes. Indeed, were SBC's view accepted, SBC would effectively destroy any competitor's ability to use combinations of network elements, and most importantly the UNE-platform ("UNE-P"), as part of a mass market entry plan to serve residential customers. That is undoubtedly SBC's intent, as SBC's recent public statements condemning competition through UNE-P make clear. Nevertheless, by threatening to withdraw access to UNE-P in California at the very time CLECs are beginning to use UNE-P to compete, SBC is exploiting its monopoly control over the essential inputs to competition in a manner that delays, deters, and disrupts local competition. By continuing to litigate the validity of this Commission's rules, even after losing the issue in the United

[9] *Id*.

States Supreme Court, SBC precludes any finding that it has fully implemented its obligation to provide nondiscriminatory access to UNE combinations.

As set forth in Part III, Pacific also has not demonstrated that CLECs have nondiscriminatory access to Pacific's operations support systems. The denial of equivalent access to OSS is stark with respect to the CLECs' lack of access to information concerning whether a customer has chosen to be listed, in their directory listing, by an alternative (or "prestige") community name rather than by the community name listed in their mailing or service address. Pacific's customer representatives have immediate access to this information, but CLEC representatives do not; as a result, a substantial percentage of CLEC orders is rejected automatically by Pacific's systems. While Pacific has acknowledged the discriminatory access and the need for an effective solution, it has yet to implement one – and it is highly questionable whether the solution that Pacific has scheduled for implementation even addresses the problem that AT&T is experiencing.

Pacific also has failed to show that its OSS are operationally ready. Conspicuously absent from both the testing Pacific has undergone and the commercial data Pacific reports is any evidence that CLECs will be able successfully to submit UNE-P orders over the EDI interface, and to avoid undue problems with maintenance and repair, particularly as CLECs migrate to the use of Pacific's uniform interfaces and LSOG Version 5. Although the successful use of this interface is critical to establishing and sustaining meaningful local competition, Pacific has provided neither adequate commercial nor test data to support a finding that its interfaces are operationally ready, and Pacific's performance data are not reliable and do not establish checklist compliance. Nor can the Commission rely on Pacific's performance incentive plan to cure these problems. Even if the data were reliable, the structure of the plan itself contains critical defects that operate, in practice, to relieve Pacific from paying significant penalties even for substantial and repeated violations of its non-discrimination obligations. These shortcomings preclude a finding that the plan will promote future checklist compliance or prevent backsliding.

Pacific also is systematically defeating CLECs' access to critical technical support by shifting responsibility for CLEC support from one support center – which is subject to regulatory oversight through performance reporting and penalty requirements – to another support center, which is not. Not surprisingly, the service at the unregulated center is far worse than at the original center, thus again driving up competitors' costs and obstructing competitors' ability to compete. Yet because the new Center is outside Pacific's performance reporting obligations, CLECs have no recourse to enforce Pacific's obligation to provide effective technical support that allows CLEC representatives to access Pacific's OSS in a manner comparable to the access that Pacific's representatives enjoy. Pacific's refusal to provide a test environment that allows CLECs to adequately test all relevant aspects of the ordering process in a mechanized way further exacerbates the discriminatory access to OSS.

Each of these checklist deficiencies is significant and precludes approval of Pacific's application, and yet each is in addition to the checklist non-compliance that the CPUC has already identified. As the CPUC explained, and as summarized in Part IV, Pacific has yet to demonstrate that it has fully implemented the competitively "crucial" enhancement to its systems necessary to prevent Pacific from wrongly disconnecting the dial tone of a competitor's prospective customer.[10] While Pacific implemented an enhancement since the filing of its application, there is no evidence in the record that the problem has in fact been resolved, let alone that the CPUC has verified such compliance as Congress intended. In addition, Pacific has made no effort to comply with the CPUC's finding that Pacific is unlawfully using the fiction of multiple corporate affiliates to avoid its

[10] *CPUC 2002 271 Decision* at 3, 96-99.

obligation under checklist item 14 to provide DSL Transport to competitors at an avoided cost discount.

Pacific's chicanery with respect to the use of corporate affiliates, however, goes far beyond the concerns raised by the CPUC in its 271 Order. Because the CPUC closed the evidentiary record in September 2001, the CPUC had no occasion to consider the extraordinary findings of the independent audit of Pacific that the CPUC had ordered. The "Pacific Audit Report," issued and supplemented in February, May, and June, 2002, contains dramatic findings of gross accounting misconduct that preclude any finding that Pacific's long distance affiliate will operate in compliance with Section 272. The Audit Report finds, for example, that Pacific (1) underreported net income by approximately $2 billion over the three-year period reviewed, thereby allowing Pacific to pocket $350 million that should have been refunded to ratepayers; (2) improperly cross-subsidized Pacific by paying it $400 million in one year alone for the use of Pacific's name; (3) further improperly cross-subsidized Pacific, in an unreported and unreimbursed amount estimated to be of at least $400 million in value, by providing Pacific with CPNI gathered by Pacific; (4) failed to establish proper internal accounting controls with respect to Pacific's long distance and other affiliates, and failed to comply with affiliate transaction requirements; and (5) delayed and obstructed the audit by imposing undue restrictions on its scope and refusing to provide some of the data requested.

Thus, as set forth in Part V, this Audit Report, together with the facial deficiencies in Pacific's conclusory submissions with respect to Section 272, make it impossible reasonably to conclude on this record that Pacific and its 272 affiliate, SBC Services ("SBCS"), will operate in compliance with the requirements of Section 272. Sections 272(b) and (c)(1) require, for example, that Pacific not improperly subsidize the operations of SBCS. Yet the CPUC-commissioned independent audit has just found that PacBell today is in fact engaging in massive cross-subsidization of SBC in two respects that each provides direct and unlawful benefits to SBCS – promoting the SBC brand name, and slashing customer-acquisition costs by providing free access to Pacific's unique statewide storehouse of extraordinarily valuable CPNI. These findings alone preclude a finding of compliance with Section 272. And yet the Audit Report contains yet additional findings of improper affiliate transactions with SBCS that also squarely bar any finding that Pacific will comply with Section 272.

Pacific further underscores its failure to demonstrate that it will comply with Section 272 with its own acknowledgement that many, if not all, of the key operations of SBCS will be obtained from other "SBC shared service affiliates." By relying on the employees of those affiliates to plan, oversee, and execute transactions benefiting SBCS, Pacific precludes any finding that the transactions between it and its long distance affiliate will be done at arm's length. Pacific's silent refusal to commit to the joint marketing safeguards ordered by the CPUC – safeguards that implement and are fully consistent with this Commission's requirements, and that the CPUC held were crucial to prevent Pacific from engaging in anticompetitive cross-subsidization of its long distance affiliate – speaks volumes about the likelihood that Pacific will comply with Section 272's joint marketing restrictions. And Pacific's noncompliance with the CPUC's recent audit bars Pacific from facile reliance on Section 272's biennial audit requirement as a cure for the overwhelming evidence that Pacific is structurally unprepared – today – to comply with Section 272. The evidence that Pacific has the intent and ability to defy regulatory oversight and cross-subsidize its long distance affiliate and leverage its local monopoly into the long distance market is thus overwhelming, and precludes any finding that it will comply with Section 272.

Given this record, it is unsurprising that the CPUC concluded that approval of Pacific's 271 application now would not serve the public interest in California. To be sure, in reaching that conclusion, the CPUC applied the state law standard for determining the public interest as set forth in

Cal. Pub. Util. Code § 709.2. But as the CPUC noted, "the language in § 709.2 borrows heavily from the Modified Final Judgment (MFJ)" (CPUC Decision 247), and Congress left no doubt that the MFJ standard could properly be considered in assessing whether to grant a 271 application.[11] Although the CPUC's views as to the public interest are not binding on this Commission, the CPUC's views also may not, as Pacific suggests, be cavalierly dismissed.

Part VI thus explains that the full record before this Commission, including but not limited to the evidence before the CPUC, shows under this Commission's established criteria that granting Pacific's application would not serve the public interest. The record contains not only the CPUC's findings of past anticompetitive conduct by Pacific, but an extraordinary record that has continued through the pendency of this application. In addition to the recent misconduct uncovered by the PacBell Audit Report, for example, a CPUC Administrative Law Judge on September 27, 2002, approved a record-setting $27 million penalty against Pacific and certain affiliates for misleading the CPUC about the number of complaints it had received concerning its DSL service, as well as for overcharging and deceiving customers. On October 3, 2002, CPUC issued another order condemning Pacific for mishandling its role as PIC administrator, and billing competitors for customers that Pacific has won back. Such findings of continuing misconduct, when combined with Pacific's defiance of the CPUC's joint marketing requirements, refusal to cooperate with state-mandated audit requests, delaying tactics in connection with UNE-pricing proceedings, planned evasion of UNE-combination obligations, and documented cross-subsidization of its affiliates, create an overwhelming record of a BOC poised to leverage its local monopoly into the long distance market.

[11] *See* 47 U.S.C. § 271(d)(2)(A) (DOJ evaluation, to which FCC must give substantial weight, may use "any standard"); Conference Report at 149, *reprinted in* 1996 U.S.C.C.A.N. 10, 161 (Section 271(d) intended to permit DOJ, through the Attorney General, to use the standard contained in Section VIII(C) of the AT&T Consent Decree, *i.e.*, the MFJ, in evaluating 271 applications).

Indeed, that is precisely what SBC is now telling industry analysts it will do. One analyst reports that SBC, in a meeting on September 10, 2002, indicated that there would be no "price war" in consumer long distance, because "RBOC pricing is in-line or higher than the IXCs'."[12] The purported consumer benefits to another long distance competitor – at least if that competitor is SBC – are thus non-existent. Yet, without competing on price, SBC reportedly "assumes that it can achieve 30% market share 12 months after entering a new market and is targeting a long run (3-4 years) penetration rate in the 60%-70% range."[13]

Thus, granting Pacific's application now will not provide consumers with any tangible benefits. To the contrary, such a grant would simply permit Pacific to extend its local monopoly into the long distance market. The technical possibility of local competition in California would thus never materialize into the "vibrant" and meaningful local competition that the CPUC has worked hard to bring about, and that competitors such as AT&T wish to provide. Unless and until Pacific fully implements its checklist obligations, establishes the safeguards against cross-subsidization that Congress, the CPUC and this Commission have deemed essential, and creates a record of consistent compliance with its market-opening obligations, permitting Pacific to offer long distance service would lead only to the very remonopolization of local and long distance markets that the Act is intended to prevent.

I. PACIFIC HAS FAILED TO DEMONSTRATE THAT ITS CALIFORNIA RATES COMPLY WITH CHECKLIST ITEM 2.

The rate issues raised by this application are unlike those raised in any prior section 271 proceeding. In contrast to prior applications, virtually *none* of Pacific's recurring loop rates, recurring switching rates, nonrecurring charges ("NRCs"), collocation rates, or signaling and

[12] Bear, Stearns & Co. Inc., Equity Research, *Highlights From Meeting With SBC Management* (Sept. 10, 2002) (attached hereto as Attachment 1).
[13] *Id.*

transport rates are the product of a TELRIC-compliant cost study. The CPUC last approved permanent rates in 1998, based on 1997 cost studies that relied on *1994* data. The CPUC has expressly recognized that the forward-looking costs of providing UNEs in California have declined significantly since 1994 with increased economies of scale, improved technology, and efficiencies created by Pacific's merger with other local Bell Operating Companies ("BOCs").[14] Accordingly, in 1999, the CPUC implemented measures to allow commencement of a re-examination of Pacific's rates to account for these substantial cost reductions. However, due to resistance and "delaying tactics" by Pacific, that process is still in its incipient stages. Pacific's transport and signaling rates continue to be based on 1994 costs and technologies. And although the CPUC has required interim rate reductions to Pacific's recurring loop and switching rates, those rate reductions are not sufficient to bring those rates within the range that a reasonable application of TELRIC principles would produce. In light of the CPUC's express recognition that Pacific's existing UNE rates reflect stale data and must be reformed, there is no possible reasoned basis for this Commission to conclude, based upon its own independent analysis of 1997 cost studies populated with 1994 data, that Pacific's current UNE rates are the product of a reasonable application of TELRIC.

For that reason, Pacific's primary defense of its California recurring rates is to contend that, regardless of the obvious problems with the process used to generate its 2002 UNE rates, those rates happen to fall within a reasonable TELRIC range, as demonstrated by comparing them to Texas "benchmarks."[15] Texas, however, is not a legitimate benchmark state, because Texas rates, which were themselves adopted based on 1996 and earlier data, can no longer be considered TELRIC-

[14] *See* CPUC Decision 99-11-050 (November 18, 1999) ("*CPUC 1999 Pricing Order*") ("the TELRIC costs we adopted [in 1998 and]. . . are based largely on data that has not been updated since 1994" and "there is evidence that some of these costs may be changing rapidly").

[15] *See* Application at 31-33.

compliant.[16] The Commission's Synthesis Cost Model and SBC's reported data both independently confirm that the Texas recurring switching and loop rates are inflated by at least 25-30 percent, even assuming (contrary to fact) that TELRIC principles were properly applied to the 1996 and earlier data. The Commission itself has recognized the central flaw in Pacific's benchmarking request, ruling that simply to presume that the rates in a section 271 approved state automatically establish TELRIC-compliance for benchmarking purposes would "forever freeze TELRIC ratemaking to the first TELRIC rate proceeding and *de facto* fail to recognize increased sophistication in modeling or newly available evidence that could produce different, more precise TELRIC refinements that result in increased or decreased wholesale prices for UNEs."[17]

Moreover, Texas is an inappropriate benchmark for California in all of the other respects the Commission has deemed relevant, including the substantial differences in the Texas and California rate structures, geography and operating companies. Because Texas is an inappropriate benchmark for California, Pacific simply cannot rely upon the benchmarking shortcut to checklist item 2 compliance, and must instead demonstrate that its California rates are the product of a reasonable application of TELRIC principles.

Pacific has not even seriously attempted to do so. Pacific cannot rely on the findings of the CPUC, because the CPUC has made no finding that Pacific's current "interim" rates are TELRIC-compliant. On the contrary, the CPUC has confirmed that Pacific's California rates are hopelessly outdated and that the limited discounts that produced the interim loop and switching rates do not capture all of the relevant cost decreases. And there is no independent basis for a Commission finding that the CPUC was wrong and that California interim rates that are, in fact, the product of the

[16] *Pennsylvania 271 Order* ¶ 67 ("[w]ithout a finding of TELRIC compliance for the benchmark state, a comparison loses all significance.").
[17] *Rhode Island 271 Order* ¶ 46.

1997 cost studies and the 1994 data and a few "rough cut" discounts to loop and switching rates are the product of a TELRIC-compliant methodology and fall within a reasonable TELRIC range.

Lacking any legitimate arguments that it has satisfied its burden to prove present compliance with the requirement of cost-based UNE rates, Pacific urges the Commission to bless this application on the theory that rates will some day be cost-based and that when permanent rate proceedings are concluded, the interim rates will be trued up. That argument must be rejected out of hand, because Pacific's overstated NRCs, collocation rates, and signaling and transport rates are *not* subject to true-up. Even ignoring those other rates, however, the existence of a true-up mechanism for Pacific's loop and switching rates could not justify approval of Pacific's application. To be sure, the Commission has approved section 271 applications where a small subset of rates were interim and subject to true-up. But in those cases, the Commission rested its findings on the fact that it was not the case that "UNE-P rates [were] . . .interim, and the vast majority of interim recurring rates . . . [were] zero."[18] By contrast, all of Pacific's recurring switching and loop rates are interim, and none is set to zero.

Finally, the TELRIC violations associated with rates that are the product of the 1997 cost studies are by no means limited to the failure to account for substantial cost decreases, which prevent Pacific from meeting its checklist burden with respect to any of the UNE rates. There are, in addition, a host of loop and non-loop problems with Pacific's cost studies that AT&T and others will raise in the permanent cost proceedings before the CPUC. AT&T does not (and need not) raise each of those TELRIC issues in this proceeding. There are, however, a few such issues that are such obvious and straightforward TELRIC violations that the Commission should address them in its order denying this application. For example, in adopting Pacific's non-recurring charges, the CPUC recognized that those charges recover the costs of certain recurring charges in violation of the

[18] *Arkansas/Montana 271 Order* ¶ 64.

Commission's TELRIC rules. However, the CPUC has never revised the NRCs to remove the non-recurring costs. Furthermore, in contrast to most other jurisdictions, Pacific's switching rates include a separate vertical feature charge for each of Pacific's 31 vertical features. But Pacific's vertical feature costs are based on Pacific's purported costs "managing" those vertical features – costs that only exist because Pacific has implemented an unlawful separate vertical features charge.

A. Pacific Has Failed To Satisfy Its Burden Of Establishing That Its California Rates Are TELRIC Compliant.

In 1999, the CPUC adopted permanent California UNE rates for Pacific based on 1998 cost studies.[19] In that order, the CPUC expressly recognized that rates are based on the "the TELRIC costs we adopted [in 1998 and]. . . are based largely on data that has not been updated since 1994"[20] and that "there is evidence that some of these costs may be changing rapidly."[21] Accordingly, the CPUC committed to re-examining rates for any element where it is clear that there has been a "reduction in costs for that element of at least 20% from the costs" initially adopted by the Commission.[22]

In February 2001, AT&T and WorldCom ("Joint Applicants") filed evidence with the CPUC showing that Pacific's costs for the recurring switching and loop elements had in fact declined by substantially more than 20% since those costs were initially adopted.[23] On June 14, 2001, the CPUC found that the "evidence presented by Joint Applicants led to a reasonable presumption that the costs may have declined for unbundled loop and switching elements."[24] Thus, the CPUC opened a proceeding to update Pacific's recurring loop and switching rates.

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[19] *See* CPUC Decision 99-11-050 (November 18, 1999) ("*CPUC 1999 Pricing Order*").
[20] CPUC 1999 Pricing Order at 168.
[21] *Id.*
[22] *Id.* at 168-169.
[23] *See* CPUC Decision 02-05-042, at 4-5 (May 16, 2002) ("*CPUC Interim Rate Order*") (summarizing the carriers' showings).
[24] *Id.* at 5-6.

As a starting point for reexamination of those rate elements, the CPUC ordered Pacific "to file switching and loop cost studies."[25] The CPUC emphasized that Pacific's cost studies should be capable of replicating [the original rates]," and that any cost model should comply with certain specified criteria, *i.e.,* the cost model should (1) show how costs were derived; (2) allow third parties to replicate the results; and (3) be capable of allowing inputs to be modified.[26] But Pacific failed to comply with that order. As explained by the CPUC, "Pacific has presented us with a black box that does not allow us to test the summary of evidence that initially persuaded the Commission to open the case. . . . The Commission must either trust Pacific's black box without further scrutiny, or delay the case while the [CPUC] . . . investigates other models or a revised model from Pacific."[27]

The CPUC ultimately chose to delay the adoption of permanent rates, opting instead to adopt interim rates. The CPUC reasoned that such a solution would reduce the harm caused by Pacific's "delaying tactics."[28] Predictably, Pacific again sought to delay further any rate reductions by challenging the CPUC's authority to set interim rates.[29] The CPUC rejected those arguments, and ultimately began the process of developing interim recurring loop and switching rates.[30]

On May 16, 2002, the CPUC adopted interim rates that, by their nature, are not based on any rigorous application of TELRIC principles. On the contrary, the interim rates are based on a rough assessment of *some* of the declines in Pacific's switching and loop costs since 1994. Lacking any legitimate cost study from Pacific, the CPUC established interim switching rates and interim loop rates. The interim loop rates are based on a cost model submitted by AT&T and WorldCom – HAI

[25] *Id.* at 6.
[26] *Id.* at 7.
[27] *Id.* at 15.
[28] *See id.* at 10.
[29] *See id.* at 10-12.
[30] *See id.*

Model 5.2a – to estimate the magnitude of those loop cost declines by varying a small subset of inputs used in that model.

In many respects, however, the CPUC determined that accounting for particular cost declines required more time, and thus postponed addressing those factors to the permanent rate proceeding. For example, AT&T and WorldCom demonstrated that Pacific's loop expenses had also declined substantially since 1994. The CPUC agreed: "we find that Joint Applicants have provided preliminary evidence of expense cost declines based on actual data."[31] However, the CPUC ultimately concluded that "[b]ecause we are setting interim rates that will be subject to true-up, we will use a conservative approach" and not account for expense declines in the interim rates.[32] The CPUC has committed to "explore further [the declines in loop expenses] when . . . set[ing] final rates for loops."[33]

Similarly, the Joint Applicants demonstrated that Pacific's loop rates fail to reflect the substantial line growth in Pacific's network associated with the massive increase in high-capacity access lines that are used for non-switched services such as high capacity business "DS-1" and "DS-3" lines. The Joint Applicants further demonstrated that high capacity DS-1 and DS-3 lines share many components of the network with the basic copper loops, *e.g.,* DS-1 and DS-3 loops share the outside plant structures – poles, conduit, and trenching associated with buried and underground plant. Therefore, to compute per-line loop costs, it is critical to allocate these costs properly to high-capacity loops on a per line basis that is consistent with the way those costs are allocated to voice-grade lines. In this regard, it is common practice to count DS-1 and DS-3 lines as voice-grade equivalents ("VGE"), where one DS-1 line is counted as 24 voice-grade lines, because each DS-1 line

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[31] *Id.* at 40.
[32] *Id.* at 39.
[33] *Id.* at 40.

has the same capacity as 24 copper voice lines, and one DS-3 is counted as 672 voice-grade lines, because each DS-3 line has the same capacity as 672 copper voice lines. Pacific, however, claimed that line count growth should continue to be based on "physical line counts," which substantially understates the number of voice-grade lines served in Pacific's network.

The CPUC determined that, because the VGE approach could overstate line growth, it would not be appropriate to adopt the VGE approach for setting interim rates. Instead, the CPUC found that "[f]or this interim rate setting exercise, we prefer to adopt a more conservative approach,"[34] and counted and copper pair and DS-3 as a single line, and each DS-1 as two lines.

By deferring assessment of the reductions in Pacific's cost declines associated with loop expense reductions and VGE line growth to the permanent rate proceeding, the CPUC's interim rates are not remotely sufficient fully to address the substantial rate inflation caused by the fact that Pacific's rates are based on severely outdated data. As noted by the CPUC, "the removal of [expense] factor [reductions], coupled with [the]. . . removal of the VGE line count method, has the effect of reducing the relative change in loop[] costs from 1994 to 2000 from 36% to 15%."[35] Thus, it is clear that the CPUC's interim rate reductions do not remotely account for the full amount of rate inflation caused by the fact that Pacific's rates are based on very old data.

Of course, Pacific's other rates – including signaling and transport rates – continue to be based fully on Pacific's outdated costs studies and 1994 data. AT&T has petitioned the CPUC to open proceedings to address many of these rate elements, but given Pacific's prior delaying tactics, and the fact that the CPUC is still in the process of developing cost-based rates for the recurring switching and loop elements, it remains uncertain when those other rate elements will be updated to reflect today's TELRIC costs.

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[34] *See id.* at 28.

On this record, then, there is no basis for a finding that California rates are the product of a TELRIC-compliant methodology.

B. Texas Rates Are Not A Valid Benchmark For Assessing California's Rates.

Unable to defend its rates on the merits, Pacific claims that its California rates nonetheless fall within a reasonable TELRIC range because they satisfy the Commission's benchmarking test, using Texas as the benchmark state.[36] But that argument can be given no weight. Commission precedent (and common sense) conclusively establish that Texas rates are not a valid benchmark for assessing California's rates.

The Commission's benchmark test is a short-cut method for assessing whether rates in an applicant state are TELRIC-compliant. If the cost-adjusted rates in an applicant state are similar to those in a benchmark state where rates are known to be TELRIC-compliant, then the Commission presumes that the rates in the applicant state also are TELRIC-compliant.[37] Of course, to state the test is to state its limitations. The rates in the benchmark state must be TELRIC-compliant, and the benchmark state must have a rate structure, and other characteristics that are sufficiently similar to the applicant state so that a valid rate comparison can be made. Absent these conditions, a benchmark test is meaningless.[38]

Given these limitations, there is no question that that Texas is not a valid benchmark state for assessing California's rates because: (1) Texas rates are not TELRIC-compliant; (2) Texas rates are based on a different rate structure than those in California; (3) Texas and California have substantial

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[35] *Id.* at 40.

[36] Application at 31-33.

[37] *See, e.g., Pennsylvania 271 Order* ¶ 63-54.

[38] *Pennsylvania 271 Order* ¶ 67 ("[w]ithout a finding of TELRIC compliance for the benchmark state, a comparison loses all significance.").

geographic and demographic differences; and (4) Texas and California are served by different BOCs. Accordingly, Pacific's benchmarking analysis can be given no weight.[39]

1. Texas Rates Are Not TELRIC-Compliant.

There is no question that the Texas rates are inflated above TELRIC levels. Texas rates were originally adopted in 1998, based on 1997 cost-studies and 1996 and earlier data. Since 1996, the costs of providing UNEs in Texas have fallen precipitously. This fact is confirmed by three independent sources. First, the Commission's Synthesis Cost Model shows that forward-looking loop and switching costs have declined in Texas by at least 29 percent and 33 percent respectively since 1996.[40] Second, cost data reported by SBC in its ARMIS reports confirms that SBC's loop and switching costs in Texas have declined by at least 28 percent and 18 percent, respectively, since 1996.[41] Third, the Texas Public Utilities Commission ("TPUC") has expressly found that the Texas rates are outdated:

> [T]he evidence show[s] that SWBT's deployment of Project Pronto has changed loop plant technology, technology mix, and processes regarding loop deployment and maintenance. There is also evidence that engineering assumptions (such as higher percentage of the use of remote terminals and fiber feeder) have changed as a result of Project Pronto. . . . Project Pronto has caused the use of more fiber, declining cost of electronics, lower cost structure for NGDLC, and a reduction of the number of dispatches and maintenance processes and lower overall costs. The evidence of such changed circumstances is sufficiently compelling to merit an investigation of SWBT's forward-looking loop costs and, therefore, the UNE rates.[42]

Moreover, the TPUC rejected SBC's arguments that current Texas rates are cost-based:

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[39] The Commission has in the past expressed concern that it is limited in the amount of analysis that it can perform in the 90-day review process in section 271 proceedings. Given the conclusive evidence that Texas rates are not a valid benchmark, the Commission should focus its limited time and resources on the central issue in this proceeding – *i.e.,* whether California's rates are TELRIC-compliant.

[40] *See* Lieberman/Pitkin Decl., Tables 1 & 2.

[41] *See* Lieberman/Pitkin Decl., Tables 1 & 2.

[42] Texas 2002 Arbitration Order at 110.

> [T]here was insufficient evidence introduced by SWBT . . . to conclude that the current rates, based on the previous cost studies and data from the 1996 Mega-Arbitration, are appropriate. . . . [T]here is inadequate evidence to support the assertion that assumptions built into the 1997 Mega-Arbitration cost studies sufficiently address current deployment.[43]

Accordingly, TPUC has opened a new proceeding to update Texas' outdated UNE rates.

Put simply, the state commissions in both Texas and California have determined that the rates in those states are stale and are based on outdated data. A comparison of those rates is therefore meaningless. To the extent that California's interim rates are lower than a Texas benchmark, that shows only that the California interim rates are not as badly inflated as those in Texas. It does not show, as Pacific asserts, that the Pacific's interim California rates are TELRIC-compliant.

Pacific asserts that simply because the Commission approved SBC's Texas 271 application in June of 2000, the Texas rates must be presumed TELRIC-compliant. That is nonsense. The Commission itself has emphasized that the fact that the Commission approved a section 271 application over two years ago does not automatically mean that the rates on which that application was predicated are TELRIC-compliant today.[44]

CLECs must compete in the real world against BOC's that face *today's* costs of providing local telephone service. Setting UNE rates – and hence the costs that CLECs incur upon local entry – based on substantially higher costs that are nearly a decade old plainly would create a substantial barrier to local entry.

To be sure, the Commission has in the past relied on outdated rates as a benchmark.[45] However, in so doing, the Commission either observed that there was insufficient evidence that the

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[43] *See id.*

[44] *See, e.g., Rhode Island 271 Order* ¶ 67.

[45] *See, e.g., Massachusetts 271 Order* (relying on New York as a benchmark state)*; Missouri 271 Order* (relying on Texas as a benchmark state).

rates in the proposed benchmark state were outdated,[46] or ignored such evidence altogether.[47] In this case, by contrast, there is overwhelming and conclusive evidence that the Texas rates are *not* TELRIC-compliant. That evidence cannot reasonably be ignored and, contrary to claims advanced by BOCs in the past, there is no authority that would allow the Commission to ignore that evidence.

Specifically, BOCs have urged the Commission to ignore substantial cost declines in proposed benchmark states because the D.C. Circuit has stated, in affirming the *New York 271 Order*, that the existence of "new [cost] information" does not "*automatically* require[] rejection of section 271 applications" that rest on rates set based on older information.[48] That argument distorts and misstates the D.C. Circuit's decision.

In the New York 271 proceeding, parties argued that new cost information showed that New York's switching rates were not TELRIC-compliant. The New York commission, however, explained that the effect of the new information "on switching prices" might turn out to be "trivial" because the new information would affect the rates in multiple interconnected ways.[49] For its part, the Commission found that the new information did not "persuade us" that the New York rates "did not conform to TELRIC principles simply because [the NYPSC] failed to modify *one* input into its cost model."[50] The Commission further found that the new information provided "no basis to disagree with the New York Commission that its calculation of switching costs is a reasonable calculation of pertinent costs, arrived at by the New York Commission Staff's application of forward-looking TELRIC analysis."[51] On appeal, the D.C. Circuit affirmed the Commission's findings,

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[46] *See Massachusetts 271 Order* ¶¶ 31-32.
[47] *See Missouri 271 Order*.
[48] *AT&T* v. *FCC*, 220 F.3d, 607, 617 (D.C. Cir. 2000).
[49] *Id*.
[50] *New York 271 Order* ¶ 245 (emphasis added).
[51] *Id.* ¶ 242.

finding that the Commission is not required to ensure that every piece of recent information is reflected in those rates.[52]

That decision has no application here. In New York, the issue was whether new information that may have only a "trivial" affect on a *single* rate element in the *applicant* state is fatal to a section 271 application. Here, the issue is whether analyses showing that *all* recurring rate elements in a proposed *benchmark state* are substantially overstated precludes that state from being used as a benchmark. As the Commission has recognized, because benchmarking is a short-cut method of assessing TELRIC-compliance in the applicant state, it is imperative that the rates in the benchmark state be TELRIC-compliant.[53] Where, as here, there is conclusive evidence that the rates in the proposed benchmark state are not TELRIC-compliant, those rates cannot be used as a benchmark. As explained by the Commission, "[t]o do otherwise would be to forever freeze TELRIC ratemaking to the first TELRIC rate proceeding and *de facto* fail to recognize increased sophistication in modeling or newly available evidence that could produce different, more precise TELRIC refinements that result in increased or decreased wholesale prices for UNEs."[54] In short, benchmarking Pacific's interim rates to Texas rates established in the 1996 Texas arbitration would be unreasoned and arbitrary and could not withstand review.

2. There Are Substantial Differences In the Rate Structures, Geography and Companies Between California And Texas.

Even aside from the fact that Texas rates are not TELRIC-compliant, there are other reasons to reject Texas as a benchmark state. The Commission has identified other indicia that are relevant to whether a particular state's rates are an appropriate TELRIC benchmark. Those indicia include, (1) whether the proposed benchmark state has a similar rate structure to the applicant state; (2) whether

[52] *AT&T* v. *FCC*, 220 F.3d, 607, 617 (D.C. Cir. 2000).

[53] *Pennsylvania 271 Order* ¶ 67 ("[w]ithout a finding of TELRIC compliance for the benchmark state, a comparison loses all significance.").

the proposed benchmark state has geographic similarities to the applicant state; and (3) whether the proposed benchmark state and the applicant state have a common BOC.[55] All of these additional indicia militate *against* using Texas rates as a benchmark for assessing California's rates.

Rate Structure. The Commission has explained that a state may be an inappropriate benchmark if it has a dissimilar rate structure compared to the applicant state, because different rate structures make it very difficult to accurately compare rates between states.[56] And there are in fact substantial rate structure differences between California and Texas. For example, to compare the average non-loop rate in California and Texas it is necessary to know the average vertical feature rate – which is a component of the non-loop rate – in both California and Texas. But the rate structures in California and Texas recover vertical features costs in entirely different ways.[57] Whereas Pacific recovers the cost of vertical features through a separate rate element, SWBT recovers the costs of vertical feature costs through the recurring switching rate element.[58] That means that it is necessary to convert the California vertical features charges into an average rate that is actually paid by Pacific's customers.[59] That calculation is complex, requiring, among other things, estimation of penetration rates for vertical features in California.[60]

There also are other important differences between the rate structures in California and Texas. For example, California's switching rates utilize a "set-up and duration" cost structure which requires accurate assumptions about the duration of the average call in California in order to develop rates that

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[54] *Rhode Island 271 Order* ¶ 46.

[55] *Rhode Island 271 Order* ¶ 38; *see also Missouri/Arkansas 271 Order* ¶ 56; *Pennsylvania 271 Order* ¶ 63; *Massachusetts 271 Order* ¶ 28; *Kansas Oklahoma 271 Order* ¶ 82.

[56] *Rhode Island 271 Order* ¶ 38; *see also Missouri/Arkansas 271 Order* ¶ 56; *Pennsylvania 271 Order* ¶ 63; *Massachusetts 271 Order* ¶ 28; *Kansas Oklahoma 271 Order* ¶ 82.

[57] *See* Lieberman/Pitkin Decl. ¶ 19-20.

[58] *See id.*

[59] *See id.*

[60] *See id.*

can be benchmarked to Texas.[61] And the Texas rate structure is unique compared to all other states in that the port rate is based on rate-groupings that depend on the size of the calling areas served by particular wire centers.[62]

Geographic Differences. The Commission also has explained that a state may be an inappropriate benchmark if it has dissimilar geographic characteristics compared to the applicant state. Pacific claims that California and Texas "share certain demographic and geographic features."[63] But Pacific then compares almanac-style geographic characteristics – *i.e.,* population, number of households, persons per household, land area, number of urban places, population density in large cities, and the number of central offices – that have no direct impact on costs. In so doing, Pacific ignores the key geographic statistics that have a direct impact on costs. For example, Pacific does not address important geographic information such as the number of households served by central offices, the average number of lines served by central offices (broken down by business, residential, special access, and public lines), the average area served by a central office, the average density of lines per square mile, and the ratio of residential lines to business lines. Comparing these important geographic factors confirms that California lines are served over much smaller geographic areas than in Texas.[64] For example, in Texas, the average wire center serves 78 square miles, and there are on average 1,974 lines per square mile. By contrast in California, the average wire center serves 45 square miles, and there are on average 4,397 lines per square mile.[65] These are substantial

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[61] *See id.*
[62] *See id.*
[63] Makarewicz Decl. ¶ 9.
[64] *See* Lieberman/Pitkin Decl. ¶¶ 17-18 & Table 3.
[65] *See id.*

and important geographic differences between California and Texas, indicating that Texas is a poor benchmark against which to compare California rates.[66]

Different BOCs. California and Texas are served by different BOCs – California is served by Pacific and Texas is served by SWBT. To the extent California's and Texas rates are based on differences between the BOCs (the rates in these states were developed *before* SBC controlled both BOCs), then a rate comparison between Texas and California would be less useful to assessing whether California's UNE rates are TELRIC compliant. Indeed, different BOCs operate on different scales, deploy different network architectures, and estimate costs using often entirely different cost studies. Indeed, as explained in the attached declaration of Terry Murray (¶ 10 n.4), Pacific's cost studies are very unique compared to those in other SBC states.

The bottom line is this: Texas rates are not TELRIC-compliant and, therefore, cannot be used to assess whether Pacific's California rates are TELRIC-compliant. At best, such a comparison could only show that California's rates are similar to the rates the overstated Texas. Moreover, other critical differences between the states – *e.g.,* differences in rates structures, geography, and BOC – militate against using Texas as a benchmark state. Accordingly, Pacific's benchmark comparison to Texas is irrelevant and should be given no weight.

C. Pacific's Rates Are Also Inflated By Other Clear TELRIC Errors.

As noted, the TELRIC violations associated with rates that are the product of the 1997 cost studies are not remotely limited to the failure to account for substantial cost decreases, which prevent Pacific from meeting its checklist burden with respect to any of the UNE rates. There are, in addition, a host of loop and non-loop problems with Pacific's cost studies that AT&T and others will raise in the permanent cost proceedings before the CPUC. Because the CPUC has expressly held that

[66] *See id.*

the substantial cost declines since 1994 conclusively demonstrates that Pacific's rates are no longer TELRIC-compliant, AT&T does not (and need not) raise each of those TELRIC issues in this proceeding – indeed, the Commission has noted that the 90-day statutory review period for section 271 proceedings precludes the Commission from independently reviewing entire cost studies. There are, however, a few such issues that are such obvious and straightforward TELRIC violations that the Commission should address them in its order denying this application.

Vertical Features. Pacific's switch rates are inflated because it charges competitive LECs a separate fee for *each vertical feature* (*e.g.*, "caller ID," "three way calling" and "call forwarding"). Vertical features are provided by using hardware and software features that are already built into the switch.[67] Indeed, today's modern switches are basically large computers. Modern switches include most vertical features, which can be activated simply by "turning on" those features. The cost of vertical features therefore are incurred by Pacific when it purchases the switch. Those up-front costs are fully recovered in Pacific's switching port and usage rates. Because providing a vertical feature using a modern switch requires nothing more than "activating" software that already exists in the switch, the incremental cost of providing vertical features is virtually non-existent.[68] Pacific, however, artificially *creates* costs that would not exist without its unique costing methodology.[69] For instance, Pacific's claims that it incurs large costs to "manage" and bill each of the individual feature "products."[70] But such feature related expenses only exist because Pacific insists on billing each single feature separately.[71] Indeed, such feature-related expenses simply do not exist in other

[67] *See* Murray Decl. ¶ 8-11.

[68] *See, e.g., Local Competition Order* ¶ 414 ("the record indicates that the incremental costs associated with vertical switching features on a per-line basis may be quite small").

[69] *See* Murray Decl. ¶ 8-11.

[70] *See Id.*

[71] *See Id.*

jurisdictions because the other BOCs, including SBC's other affiliates do not treat vertical features as separate products that need to be "managed" or billed.[72]

More fundamentally, Pacific does not impute to itself any costs associated with "managing" or "billing" its vertical features.[73] That creates a classic "price-squeeze" opportunity. Although UNE-based competitors in California must pay managing and billing expenses for each feature in California, Pacific generally does not.[74] Consequently, UNE-based competitors in California would be unable to provide retail local telecommunications services that include vertical features at prices that would be competitive with Pacific.[75] Thus, Pacific's arbitrary separate charges for each vertical features is discriminatory and not cost-based in violation of Checklist Item 2.

NRCs. In December of 1998, the CPUC noted that Pacific NRCs recover "[s]o called 'loaded' recurring costs represent[ing] approximately 25% of the total costs for NRCs."[76] CLECs argued that Pacific's attempt to recover recurring costs through non-recurring rates violated the Commission's TELRIC pricing rules. The CPUC agreed that Pacific's NRCs recovered those recurring costs. However, the CPUC refused to fix the problem at that time noting that, "[w]e are well aware that the FCC's August 8, 1996 First Report & Order that prohibited ILECs from recovering recurring costs in NRCs, but that requirement has been stayed by the Eighth Circuit. Should the Supreme Court reverse the Eight Circuit's stay of pricing provisions of the First Report & Order, we will direct Pacific . . . to remove [the NRCs] . . . from their nonrecurring cost studies."[77] But the Supreme Court has now reversed the Eight Circuit's stay of the pricing provisions of the *First Report & Order*, and the CPUC has not required Pacific to remove the recurring costs from its

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[72] *See Id.*
[73] *See Id.*
[74] *See Id.*
[75] *See* Murray Decl. ¶ 8-11.
[76] CPUC Decision 98-21-079, at 49 (December 17, 1998).

NRCs.[78] Thus, Pacific's NRCs continue to be inflated above TELRIC levels by approximately 25%.[79]

D. The Fact That Pacific's Interim Switching and Loop Rates Are Subject To True-Up Does Not Satisfy Checklist Item Two.

Finally, the Commission should reject Pacific's claim that the existence of TELRIC-compliant rates is unnecessary for approval of its section 271 application because Pacific has agreed to true-up its recurring loop and switching rates to the switching rates established by the CPUC in the ongoing permanent rate proceedings. The possibility that a subset of Pacific's existing UNE rates may be adjusted by unknown amounts at some unknown future date does not begin to make Pacific's 271 application lawful.

As a preliminary matter, many of Pacific's overstated rates are not in fact subject to true-up. For example, Pacific's current NRCs and signaling and transport rates are *all* permanent and are *not* subject to true-up. Thus, even if the Commission could ignore the clear TELRIC errors that inflate Pacific's recurring switching and loop rates, it could not ignore the clear TELRIC errors that inflate Pacific's other rates.

In any event, in the previous 271 cases in which the Commission has accepted a true-up proposal in lieu of a finding that the applicant's existing rates were TELRIC-compliant, the true-up arrangements were limited to rates for a relatively small subset of the carrier's UNEs or other services. *See Georgia-Louisiana 271 Decision* ¶ 91 (accepting true-up proposal for DUF rates); *New York 271 Decision* ¶ 258 ("Uncertainty will be minimized if the interim rates are for a few isolated ancillary items"). Indeed, in prior cases the Commission expressly relied on the fact that not all

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[77] *Id.* at 53.

[78] *See* Murray Decl. ¶ 6.

[79] It also appears that Pacific very recently implemented unilaterally increases to the rates that CLECs must pay for DC power that is supplied to CLEC collocation cages. AT&T is currently investigating this issue, and will inform the Commission of the results of that investigation.

"UNE-P rates [were] . . .interim, and the vast majority of interim recurring rates . . . [were] zero."[80] Here, by contrast, the true-up mechanism in California leaves in limbo all recurring loop and switching rates, the most important (and costly) components of the UNE platform. Thus, CLECs do not know even their *current* (let alone their future) costs of entry, which could change significantly – either up or down – based on future CPUC decisions.

Such extraordinary uncertainty precludes any finding that Pacific has fully implemented its checklist obligation to make unbundled network elements available at cost-based rates. Uncertainty as to the true cost of such key inputs inevitably and negatively affects the pace of local entry with some potential entrants responding to the uncertainty over the ultimate cost of UNEs by reducing the scale of entry, and others deferring entry altogether until the costs of entry are known. The chilling effect of uncertainty as to the basic terms and conditions of local entry is presumably why Congress prohibited the Commission from approving a section 271 application until *all* of the competitive checklist items – included the establishment of cost-based rates – have been fully implemented, and why the Commission determined that a BOC could not be deemed to be "providing" a network element until the terms on which it was actually furnishing that element were "concrete," "specific," and legally enforceable.[81]

II. PACIFIC HAS NOT SATISFIED CHECKLIST ITEM 2 BECAUSE IT HAS NOT FIRMLY COMMITTED TO PROVIDE "NEW COMBINATIONS" ON A NONDISCRIMINATORY BASIS.

Section 271(c)(2)(B)(ii) requires a BOC to provide nondiscriminatory access to unbundled network elements in accordance with sections 251(c)(3) and 252(d)(1). 47 U.S.C. § 271(c)(2)(B)(ii). To satisfy this checklist item, the BOC must show that it complies with the Commission's rules governing combinations of elements, including the obligation in Rule 315(c) – recently upheld by the

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[80] *Arkansas/Missouri 271 Order* ¶ 64.

[81] *See* 47 U.S.C. § 271(a) & (c); *Michigan 271 Order* ¶ 110.

Supreme Court in *Verizon* – to provide "additional" (or "new") combinations.[82] Pacific fails to satisfy this requirement, because it is invoking the change of law provisions of its interconnection agreements to withdraw access to new combinations of UNEs, thus undermining its obligation to provide such combinations.[83]

Pacific has made clear that, in its view, it is legally required to provide only "pre-existing" combinations of UNEs, and it has invoked the change of law provisions in all of its interconnection agreements in an effort to withdraw nondiscriminatory access to "new combinations."[84] Pacific defines "new combinations" broadly as any combination that requires any "physical work" at either a Pacific premises, an outside plant location, or a customer premises "in order to establish physical connections between the UNEs that constitute the combination."[85] Thus, under Pacific's definition, new combinations would include (1) any UNE-P combination that does not involve the conversion of an existing Pacific customer or other customer already served through UNE-P or resale[86] or (2) even an existing Pacific customer if Pacific would be required to change the features available to that customer or if the customer is being served through a line sharing or line splitting arrangement.[87] In other words, Pacific's new policy would withdraw nondiscriminatory access to UNE-P in a wide variety of circumstances, including all new customers, new second lines, customers who want DSL service in addition to voice services, or even (to an extent not yet clarified by Pacific) customers that want a different set of features.[88]

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[82] *See Verizon*, 122 S.Ct. at 1683-87.

[83] *See Ameritech Michigan* ¶ 110 (checklist item satisfied only if "concrete and specific legal obligation to furnish the item upon request").

[84] *See* Fettig Dec. ¶ 6.

[85] *See* Fettig Decl., Attachment 4 (UNE Attachment § 3.3.1) ("UNE Attachment").

[86] *Id*. § 3.3.1.1(1).

[87] *Id.* § 3.3.3.1(2).

[88] Fettig Dec. ¶¶ 10-11.

For these "new" combinations, Pacific would impose extremely burdensome and anticompetitive conditions. For example, in any central office in which the CLEC is collocated, Pacific would require the CLEC itself to combine the elements in its collocation space.[89] In all other instances, Pacific would physically combine the elements for the CLEC, but it would impose duplicative "glue charges" in addition to nonrecurring costs for the elements.[90] This would deal a deadly blow to UNE-P (and DSL) competition, by effectively foreclosing the opportunity to serve customers that would require what Pacific defines as a "new" combination (which represents a sizable portion of the market).[91]

The basis for Pacific's new position is astonishing. SBC has invoked the change of law provisions in all of its interconnection agreements based on the Supreme Court's recent decision in *Verizon*. That is preposterous. *Verizon* does not represent a change of law at all; the Supreme Court *upheld* the FCC's additional combinations rule, and rejected SBC's arguments in doing so. The Supreme Court's decision therefore provides no conceivable basis for changing Pacific's prior practice – ordered by the CPUC on the basis of both the federal Rule 315(c) and California law – which was to provide access to new combinations on the same terms as it provided access to "pre-existing" combinations. Indeed, one federal district court in California has already agreed.[92]

Moreover, Pacific misreads both Rule 315(c) and *Verizon*. To begin with, Pacific's definition of a "new combination" is far broader than the Commission's rule. The Commission's *Local Competition Order* makes clear that the distinction in Rule 315 between "pre-existing" and "new" combinations is between *types* of combinations that the incumbent ordinarily combines for itself and

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[89] UNE Attachment § 3.6.

[90] UNE Attachment §§ 3.3.4 & 3.3.5.

[91] Fettig Dec. ¶¶ 20-21.

[92] *See AT&T Comm. of Cal.* v. *Pacific Bell Tel. Co.*, Case No. C01-02517CW, Slip Op. at 42 (N.D. Cal. August 8, 2002) ("there is no evidence that the CPUC, in any decision before the Court, has required Pacific to combine elements in a

types of combinations that it does not ordinarily combine for itself. The Commission was concerned that wholly new types of combinations that the incumbent did not ordinarily perform for itself could potentially affect the security and reliability of the network and the ability of other CLECs to gain access to the incumbent's network That is why the "new combinations" rule, Rule 315(c), requires that the CLEC show that the requested new combination – *i.e.*, a combination that the incumbent does not ordinarily combine for itself – would be technically feasible and would not interfere with other CLECs' access. If "new combinations" meant merely new customers, or where Pacific had to perform routine "work" to establish combinations that it establishes for itself all the time, the technical feasibility and other requirements of Rule 315(c) would make no sense.

The Commission cogently (and unambiguously) explained this distinction in the *Local Competition Order* (¶ 296):

> Accordingly, incumbent LECs are required to perform the functions necessary to combine those elements that are ordinarily combined within their network, in the manner which they are typically combined. Incumbent LECs are also required to perform the functions necessary to combine elements, even if they are not ordinarily combined in that manner, or they are not combined in the incumbent's network, provided that such combination is technically feasible, and such combination would not undermine the ability of other carriers to access unbundled elements or interconnect with the incumbent LEC's network.

Thus, Rule 315(c) may not properly be invoked to limit CLECs' access to UNE-P, because UNE-P involves a combination of elements that Pacific ordinarily combines for itself in its network on a routine basis. As such, under Rule 315(b), Pacific is prohibited from separating the elements that comprise UNE-P when they are ordered in combination.[93]

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manner that is broader than that required by the FCC's combination rules, which have been approved by the Court in *Verizon*"); *see also* Fettig Dec. ¶ 8.

[93] *See* 47 C.F.R. § 51.315(b); *Iowa Utils. Bd.* 525 U.S. at 395.

Furthermore, the Supreme Court's decision in *Verizon* makes it clear that Pacific is obligated to combine the elements of UNE-P for the CLEC. At issue in *Verizon* was the decision of the Eighth Circuit to vacate the FCC's new combinations rules,[94] which require Pacific and other incumbent carriers, upon request, to "perform the functions necessary to combine unbundled network elements in any manner, even if those elements are not ordinarily combined in the incumbent LEC's network."[95] The Eighth Circuit had held, contrary to three Ninth Circuit decisions, that the Act required new entrants, and not incumbent LECs, to combine new elements.[96] In the Eighth Circuit's view, "the nondiscrimination language in § 251(c)(3)" did not support the FCC's new combinations rules, and it was therefore irrelevant, given the plain language of the Act, that "new entrants would incur higher costs for unbundled network elements than the ILECs incur."[97]

The Supreme Court reversed both the Eighth Circuit's result and its rationale. In upholding Rules 315(c)-(f), the Supreme Court held that the duty to combine network elements "is consistent with the Act's goals of competition and nondiscrimination, and imposing it is a sensible way to reach the result the statute requires."[98] The overall goal of the 1996 Act, the Court found, was "to eliminate the monopolies enjoyed by the inheritors of AT&T's local franchises."[99] Rules 315(c)-(f) play an important part in achieving that goal, because they help "ensure that the statutory duty to provide unbundled network elements gets a practical result."[100] The Supreme Court also noted that Rule 315(c) "neatly complements the facially similar Rule 315(b), upheld in [*Iowa*], forbidding incumbents to separate currently combined network elements when the entrant requests them in

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[94] 47 C.F.R. §§ 315(c)–(f).
[95] 47 C.F.R. § 315(c); see *id.* §§315(d)-(f) (imposing related requirements).
[96] *Iowa Utils. Bd.* v. *FCC*, 219 F.3d 744, 759 (8th Cir. 2000); see *id*. (refusing to follow *U.S. West Communications* v. *MFS Intelenet, Inc.*, 193 F.3d 1112, 1121 (9th Cir. 1999)).
[97] *Iowa Utils. Bd.*, 219 F.3d at 758.
[98] *Verizon*, 122 S.Ct. at 1687.
[99] *Id*. at 1654.
[100] *Id.* at 1683.

combined form."[101] Therefore, as under Rule 315(b) (*see Iowa*, 525 U.S. at 395), the incumbent must combine such elements when the CLEC orders them in combined form.

Second, even if Pacific could somehow contend that UNE-P is a combination not "ordinarily" combined in its own network, the Supreme Court again made clear that Pacific is still obligated to provide those elements in combined form. For example, contrary to Pacific's proposal, the Supreme Court expressly considered the application of the rule to "a second-line connection, for a fax or modem," which the Court noted might not qualify as an "ordinary" combination. The Court concluded that "[t]here is no dispute that the incumbent could make the connection more efficiently than the entrant," and that the incumbent would provide the combination for itself if a customer so requested.[102] Accordingly, the Court specifically found that the incumbent must establish the combination for the new entrant, for "otherwise, an entrant would not enjoy true 'nondiscriminatory access' notwithstanding bare provision on an unbundled basis of the network elements it needs to provide a service."[103] Thus, the Supreme Court squarely rejected the Eighth Circuit's holding and rationale that the new combination rules were invalid and not supported by the "nondiscrimination" obligation of section 251(c).

Pacific's new scheme, however, is designed to do precisely what the Supreme Court held was unreasonable and discriminatory – relegate competitors to the "bare provision" of network elements on an unbundled basis, forcing them to combine them. If imposed, Pacific's requirements would be severely anticompetitive. Whenever AT&T orders a "new" UNE-P combination in a central office in which it is physically collocated, Pacific would require AT&T to perform the "work" of combining the *Pacific* loop and the *Pacific* switch in the AT&T collocation cage. There is no conceivable

[101] *Verizon*, 122 S.Ct. at 1686.
[102] *Id*.
[103] *See* 47 U.S.C. § 251(c)(3); *Verizon*, 122 S.Ct. at 1686.

justification for such a policy in either the rule, the *Verizon* decision, or any legitimate engineering or economic feature of the network; rather, it is designed solely to raise AT&T's costs to a level at which AT&T can no longer compete.[104] And Pacific's new "glue charges" are meant to accomplish the same purpose in central offices in which AT&T is not collocated. In all such circumstances, Pacific is denying nondiscriminatory access to UNEs by separating elements that the CLEC orders in combination and which Pacific would provide to itself in combination.

In short, the Supreme Court found that the touchstone of Rule 315(c) is that it is "best understood as meant to ensure that the statutory duty to provide unbundled elements gets a practical result."[105] By reading *Verizon* as permitting it to impose the most impractical arrangements imaginable, Pacific has turned that holding completely on its head. Yet even after Pacific has litigated the issue all the way to Supreme Court and lost, and then litigated the issue in federal district court in California and lost, Pacific continues to force CLECs to litigate this same issue and threatens them with the possibility that Pacific will remove a central pillar of their residential market entry plan. Such continuing defiance of Pacific's legal obligations illustrates the extraordinary lengths Pacific is prepared to go to drive up the litigation costs of its competitors. And these war-of-attrition tactics impose tremendous uncertainty over the continuing availability of UNE-P that has Pacific's intended effect of delaying and deterring competitive local entry. Pacific has thus announced its intention not to comply with its obligations to provide combinations of UNEs on nondiscriminatory terms. In these circumstances, where Pacific is flagrantly refusing to acquiesce in any reasonable commitment to provide UNE-combinations, Pacific cannot reasonably be found to have fully implemented its obligations to provide nondiscriminatory access to UNEs, as required by Sections 251(c)(3) and 271(c)(2)(b)(ii).

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[104] Fettig Dec. ¶ 13.
[105] *Verizon*, 122 S.Ct. at 1684.

III. PACIFIC DOES NOT PROVIDE NONDISCRIMINATORY ACCESS TO OSS.

Because "access to OSS functions falls squarely within an incumbent LEC's duty under section 251(c)(3) to provide unbundled network elements under terms and conditions that are nondiscriminatory and just and reasonable, and its duty under section 251(c)(4) to offer resale services without imposing any limitations or conditions that are discriminatory or unreasonable," a BOC seeking section 271 authority must demonstrate that it provides nondiscriminatory access to its OSS.[106] The importance of this requirement cannot be overstated. "The Commission consistently has found that nondiscriminatory access to OSS is a prerequisite to the development of meaningful local competition,"[107] and that OSS "represent a significant potential barrier to entry."[108] Without nondiscriminatory access to the BOC's OSS, competing carriers "will be severely disadvantaged, if not precluded altogether, from fairly competing" in the BOC's local exchange markets.[109]

The evidence clearly shows, however, that Pacific has not met the Commission's longstanding two-part test for determining whether a BOC has complied with its OSS obligations under the checklist. First, Pacific has not provided CLECs with interfaces that allow equivalent access to OSS functions, or the assistance necessary to use those interfaces. Second, Pacific has not shown – and cannot show – that its OSS are "operationally ready, as a practical matter."[110]

A. Pacific Has Failed To Provide CLECs With Equivalent Access To OSS Functions, or With the Assistance Necessary To Use Its Interfaces.

Pacific has clearly failed to meet the first prong of the Commission's test. Pacific fails to provide CLECs with equivalent access to "alternative community names" that customers can, and do,

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[106] *Alabama 271 Order*, App. D, ¶ 26.

[107] *New York 271 Order* ¶ 83.

[108] *Local Competition Order* ¶ 516.

[109] *Alabama 271 Order,* App. D, ¶ 25; *New York 271 Order* ¶ 83 ("new entrants must have access to the functions performed by the incumbent's OSS in order to formulate and place orders for network elements or resale services, to install service to their customers, to maintain and repair network facilities, and to bill customers").

[110] *See, e.g., New Hampshire/Delaware 271 Order*, Att. F, ¶ 29; *Alabama 271 Order*, App. D, ¶ 29; *New York 271 Order*, ¶¶ 86-87, *Michigan 271 Order*, ¶ 136.

request for inclusion in their directory listings. In addition, the test environment that Pacific makes available to CLECs does not mirror production. Finally, Pacific does not furnish CLECs with adequate technical assistance and help desk support.

Lack of Equivalent Access To Alternative Community Names. CLECs using Pacific's electronic interfaces are denied parity of access because they lack the same access to "alternative community names" as that enjoyed by Pacific's retail operations. "Alternative community names" (sometimes called "prestige" community names) are community names that customers can request for inclusion in their directory listing in lieu of the community listed in their mailing or service address. For example, a customer in Daly City (which is located outside of San Francisco) might request that the directory list San Francisco as his or her community.[111]

Equivalent access to alternative community names is critical to a CLEC's ability to compete. Pacific's systems edit a CLEC's order for accuracy based on the community name in the actual directory listing. Thus, if a customer has requested an alternative community name, a CLEC's order will be rejected if the community name on the LSR was obtained through the customer service record or the address validation functionality of the OSS.[112]

CLECs currently cannot use the pre-ordering capabilities provided by Pacific to obtain alternative community names, because Pacific has not given CLECs access to the database – accessible to its retail operations – that contains such information. As a result of this lack of access, nearly 6 percent of the UNE-P orders that AT&T submitted in August 2002 were rejected for "invalid community names," because AT&T used the community name obtained from the CSR or the address validation function.[113]

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[111] Willard Decl. ¶ 12.
[112] *Id.* ¶ 13-14.
[113] *Id.* ¶¶ 14-15.

Although AT&T has repeatedly brought this problem to Pacific's attention, Pacific's response has been inadequate. Pacific initially suggested that AT&T obtain information about alternative community names by calling its directory listings help desks – a process that would require AT&T to expend thousands of hours of additional hours of labor, at substantial additional expense.[114] Then, in response to AT&T's criticism of this procedure, Pacific provided AT&T with a "flat file" that simply correlates particular mailing or service communities to the available alternative community name. The file does not enable the CLEC to determine whether a particular customer is currently using an alternative community name in its directory listing – which is the information that a CLEC needs to avoid order rejections.[115]

Pacific recently advised AT&T that it would implement a change request in mid-October 2002 which will allow AT&T to receive alternative names in response to queries by using its pre-ordering interfaces. But the particular change that Pacific is proposing to make will not fix the problem or provide AT&T with nondiscriminatory access to alternative community names.[116] Alternative community names are clearly popular among customers, as demonstrated by the thousands of AT&T orders already rejected for "invalid" community names.[117] The lack of access to such information results in the rejection of significant volumes of CLEC orders and imposes unnecessary additional costs on CLECs. Because Pacific's retail operations, through their direct access to alternative community name information, do not experience these problems, Pacific is clearly denying parity.[118]

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[114] *Id.* ¶ 16.

[115] *Id.* ¶ 17. Pacific also rejected AT&T's proposal for an interim manual "workaround" under which an order with an "invalid" community name would fall out for manual processing by Pacific, at no additional charge to the CLECs. Pacific, however, rejected that proposal. *Id.* ¶ 18.

[116] *Id.* ¶ 19.

[117] *Id.* ¶ 21.

[118] Pacific also denies nondiscriminatory access to alternative community names because it has failed to provide CLECs with adequate instructions and guidelines regarding the use (and availability) of such names in the ordering of new

Failure To Provide an Adequate Test Environment. As part of its OSS obligations, Pacific is required to provide CLECs with "a testing environment that mirrors the production environment."[119] As the Commission has recognized, a testing environment that mirrors production is critical to CLECs, because it avoids "a competing carrier's transactions succeeding in the testing environment but failing in production."[120]

Pacific's test environment, however, does not mirror its production environment. First, the test environment allows CLECs to perform mechanized testing only for accounts in Northern California – not for accounts in Southern California. Because Pacific designates one wholesale billing account number ("BAN") for Northern California and a different wholesale account number for Southern California, a CLEC which (like AT&T) provides service in both regions has two BANs. Moreover, some LATAs in California overlap both regions – and NPA/NXXs in those regions will have different BANS, depending on the region in which they are located.[121]

Thus, it is critical that CLECs be able to use the test environment to determine whether, in these "overlapping LATAs," the BAN that they are using for a particular NPA/NXX in that LATA is correct, because an order with an incorrect BAN will be rejected by Pacific's systems.[122] CLECs, however, cannot perform mechanized testing for this purpose, because the current test environment cannot be used for mechanized testing of accounts in the Southern California region. The manual testing offered for this purpose by Pacific (which consists of a manual review of the BANs for correctness by Pacific) provides no indication of how orders from these LATA will perform in actual production, where they will be submitted and processed on a mechanized basis.

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accounts. As a result, CLECs lack access to basic information about an option that they clearly need to offer in order to be competitive with Pacific. *Id.* ¶¶ 21-22.

[119] *See, e.g., New York 271 Order* ¶ 109.

[120] *Alabama 271 Order* ¶ 187; *Texas 271 Order* ¶ 132.

[121] Willard Decl., ¶¶ 25-26.

The unavailability of the test environment to conduct fully mechanized testing impairs AT&T in the production environment in a number of respects. For example, because SBC poorly documents the BAN/NPA-NXX relationships and because the table of BANS that are split between the Northern and Southern regions is not easily obtained from SBC, AT&T needs to conduct testing whenever SBC updates or modifies its NPA/NXXs to ensure that SBC has properly advised the CLECs as to which type of BAN (North or South) they should use with the NPA/NXXs. Similarly, when SBC implements a new systems release (as it does about four times each year), AT&T needs to conduct regression testing to ensure that SBC's changes have not corrupted their tables or the underlying logic on SBC's side of the gateway. And, when AT&T itself issues a new, internal release that modifies its systems (as AT&T does about ten times each year), AT&T must be able to perform regression and release testing to ensure that the changes it makes do not corrupt our tables or underlying logic. Yet, because of the limitations of Pacific's current test environment, AT&T is unable to make these determinations until it uses the OSS in actual production where its orders may be rejected.[123]

Second, Pacific's test environment does not enable CLECs which (like AT&T) are still operating under LSOG 3.06 to test the production environment that will occur after they migrate to LSOG 5. Under Pacific's versioning policy, after a CLEC converts to LSOG 5, it will still receive responses to orders it had sent under LSOG 3.06. Pacific, however, has refused AT&T's request to test post-conversion transactions in the test environment. Thus, until the actual conversion, AT&T has no means of determining through testing whether it will receive proper responses to pre-conversion orders in actual production.[124]

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[122] *Id.* ¶¶ 26-27.
[123] Willard Decl. ¶ 25-30.
[124] *Id.* ¶¶ 31-32.

Lack of Adequate Technical Assistance and Help Desk Support. As part of its OSS obligation to "adequately assist[] competing carriers . . . to use all of the OSS functions," Pacific must provide sufficient technical assistance and help desk support to assist CLECs in using the OSS, resolving problems, and answering inquiries from CLECs as they occur.[125] Rather than do so, however, Pacific has simultaneously made it more difficult for CLECs to obtain the assistance that they need, and impossible for regulators to track Pacific's performance in this area.

Although it originally designated its Local Service Center ("LSC") – whose performance is subject to reporting requirements and performance measurements – as the CLECs' primary support entity, Pacific has increasingly shifted many of the LSC's functions to a new center, the Mechanized Customer Production Support Center ("MCPSC"). Pacific, however, has never clearly delineated the division of responsibilities between the LSC and the MCPSC, thereby creating confusion among the CLECs as to which of the centers they should contact to resolve particular problems.[126]

In addition, the MCPSC's performance has been inadequate in those instances when AT&T has sought its assistance. Since the fall of 2001, the MCPSC has been inadequately staffed, insufficiently knowledgeable, and slow to respond. For example, AT&T experienced extraordinarily long hold times (longer than 1 hour) when calling the MCPSC for assistance through June 2002. The long hold times were apparently the result of inadequate staffing and training at the MCPSC (a problem that Pacific acknowledged to AT&T in November 2001).[127] Furthermore, personnel at the

[125] *See Texas 271 Order* ¶ 144; *New York 271 Order* ¶ 126 & n.261.

[126] Willard Decl. ¶¶ 34-35. AT&T's experience illustrates the confusion. The MCPSC initially advised AT&T that it should always contact the LSC when AT&T experienced problems. In July 2002, however, the MCPSC advised AT&T that its previous statement had been incorrect – and that CLECs should contact the *MCPSC* for assistance in resolving such problems (except in those instances where AT&T's orders were manually rejected). *Id.* ¶ 36.

[127] Willard Decl. ¶¶ 37-38.

MCPSC frequently lack the training and expertise to deal with OSS problems, thereby delaying their resolution even further.[128]

Despite its claims that AT&T's complaints about the MCPSC are "unwarranted,"[129] Pacific offers no evidence to support its bald assertions that MCPSC personnel are well-trained and that the MCPSC's hold times have generally been low. In fact, Pacific's assertions are flatly contrary to AT&T's experience.[130]

The poor performance of the MCPSC should be of particular concern here, because its performance is not captured by any performance measurements or subject to payments under Pacific's PIP. As the MCPSC's workload increases – as it undoubtedly will – resolution of issues by the MCPSC will take even longer, while the absence of regulatory monitoring will give Pacific no incentive to improve its performance. Indeed, although its call hold times have shown improvement since July 2002, the MCPSC is likely to revert to its previous poor performance as soon as Pacific's application is approved, given the absence of regulatory monitoring. In these circumstances, Pacific cannot reasonably be found to be providing adequate assistance and technical support to CLECs.[131]

B. Pacific's OSS Are Not Operationally Ready.

Pacific also cannot show that its OSS are operationally ready, as a practical matter. The Commission has repeatedly held that "The most probative evidence that OSS functions are operationally ready is actual commercial usage in the state for which the BOC seeks section 271 authorization."[132]

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[128] *Id*.
[129] Huston/Lawson Aff. ¶ 267.
[130] Willard Decl. ¶ 41.
[131] *Id.* ¶¶ 41-42.
[132] *Alabama 271 Order* ¶ 129. *See also, e.g., Georgia/Louisiana 271 Order*, App. D, ¶ 31; *New York 271 Order* ¶ 89; *Michigan 271 Order* ¶ 138.

Pacific, however, has not provided commercial data sufficient to permit a meaningful evaluation of its OSS. Most notably, Pacific has not shown that sufficient commercial data exists to evaluate the performance of the OSS in handling UNE-P orders submitted via the EDI ordering interface – despite the critical role of the UNE-P to market entry by CLECs, and despite EDI's status as the only interface that CLECs can use to provide service through the UNE-P on a mass-market basis.[133] More significantly, Pacific has provided no data regarding the extent to which CLECs are using its new LSOG 5 release to submit UNE-P orders via EDI, or the performance of the OSS in handling these orders.[134]

There is no reason to believe that such data, if they were presented, would demonstrate that Pacific's OSS are operationally ready with respect to the submission of UNE-P orders over EDI. For example, LSOG 5, as implemented in the former Ameritech region served by SBC, has already proven to be seriously defective.[135]

Pacific also cannot rely on the third-party testing of its OSS to demonstrate that its OSS are operationally ready. That testing did not adequately determine the ability of the OSS to handle UNE-P orders through any version of the EDI ordering interface. At most, only 83 of the more than 1,000 UNE-P orders that were tested were submitted through EDI – a percentage that Pacific itself characterizes as "relatively small."[136] Even the limited testing of UNE-P orders using EDI did not involve the LSOG 5 version that CLECs can be expected to use.[137]

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[133] Willard Decl. ¶¶ 44-46.

[134] *Id.* ¶ 47.

[135] When McLeod began testing LSOG 5 in the former Ameritech region in January 2002, it encountered so many problems with the new release that it required 9 months to submit a total of 37 test orders successfully. Willard Decl. ¶ 49.

[136] *Id.* ¶¶ 51-52; Huston/Lawson Aff. ¶ 65. The remainder of the 1,021 UNE-P orders tested were submitted through Pacific's "Web LEX" interface, which is an interface developed solely by Pacific for CLECs submitting small volumes of orders. The use of LEX could not serve as a suitable surrogate for EDI, which not only is designed for submission of mass volumes of orders but also is developed jointly by Pacific with the CLEC. Only the use of EDI itself would

C. Pacific's Performance Data Do Not Show Checklist Compliance.

There is no sound basis for Pacific's claims that its performance data are accurate, and that its data demonstrate checklist compliance. Pacific contends that the accuracy and reliability of its performance data have been confirmed by: (1) an audit conducted by PricewaterhouseCoopers ("PWC") in 1999 that culminated in PWC's audit report dated December 31, 1999; (2) two so-called "reaudits" of Pacific's data that PWC conducted in the summer and fall of 2000 which culminated in PWC's reports dated July 7, 2000 and November 9, 2000; and (3) data reconciliations that Pacific conducted with AT&T (as well as other CLECs) in 2000 and 2001. Pacific also contends that its reported results show that it has fully satisfied its Section 271 obligations. Pacific is wrong on all counts.

The FCC has held that "[p]erformance measures are an especially effective means of providing us with evidence of the quality and timeliness of the access provided by a BOC to requesting carriers."[138] However, performance measures are useful only if they accurately capture the performance they are intended to measure. In order to provide meaningful information, performance measures should be clearly defined and implemented properly.[139] As this Commission has stated, "the reliability of reported data is critical" and "the credibility of the performance data must be above suspicion."[140] Pacific simply cannot satisfy this requirement.

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determine whether the interactions of the respective EDI gateways and systems that Pacific and the CLECs build will interface successfully in the context of large volumes of order submissions. Willard Decl. ¶ 52.

[137] *Id.* ¶ 51. Even leaving aside its overall failure to establish the operational readiness of its OSS, Pacific cannot show that the maintenance and repair functions of its OSS are operationally ready. AT&T's recent entry into the California residential market provides no basis on which to conclude that these functions are operationally ready, since it is AT&T's experience that many troubles do not occur until a few months after UNE-P service is provisioned. *Id.* ¶ 53. Pacific also cannot use the evaluation of its maintenance and repair data by Cap Gemini in the third-party testing to establish operational readiness, since Cap Gemini simply assumed that Pacific was properly excluding certain trouble reports from its reported performance data. Subsequent events have shown Cap Gemini's assumption to be erroneous. *Id.* ¶ 55.

[138] *Massachusetts 271 Order* ¶ 12 (citations omitted).

[139] *See, e.g., Michigan 271 Order* ¶ 212.

[140] *Texas 271 Order* ¶¶ 428-29.

Contrary to Pacific's claims, the audit conducted by PWC in 1999, and the subsequent work that PWC performed (which Pacific erroneously characterizes as "re-audit[s] of Pacific's data)"[141] cannot legitimately be relied upon as proof that Pacific's data are accurate. The PWC initial audit was so superficial and limited in scope that it did not and could not validate the accuracy of Pacific's data.[142] Indeed, the PWC audit report dated December 30, 1999, is woefully lacking in details and glaringly omits basic information regarding the nature and scope of the testing that PWC performed. Conspicuously absent from the PWC audit report is any information regarding the replication tests, statistical methodologies and criteria that PWC used to recalculate performance results or side-by-side comparisons of any discrepancies between Pacific's reported results and those calculated by PWC.

Most important, PWC's audit report is bereft of any evidence that PWC independently validated the accuracy of Pacific's data at the initial collection stage – data that serve as the critical link in the performance monitoring and reporting process.[143] Indeed, there is no evidence that PWC tested Pacific's data by comparing Pacific's reported results against data independently collected from the CLECs, or that PWC conducted any systematic testing of Pacific's retail data. The lack of such testing alone highlights the weakness of Pacific's claim that the PWC initial audit is a reliable indicator of the accuracy of Pacific's data.[144] However, even PWC's flawed audit revealed significant deficiencies in Pacific's performance monitoring and reporting processes.[145]

Pacific claims, however, that any deficiencies in its data collection and reporting processes that were laid bare in the PWC initial audit were resolved to PWC's satisfaction during two so-called

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[141] Application at 90.
[142] Toomey/Walker/Kalb Decl. ¶¶ 15-16, 21-42.
[143] *Id.* ¶ 28.
[144] *Id.* ¶¶ 28-30.
[145] *Id.* ¶¶ 31-36.

"reaudits" of Pacific's performance data that were conducted during the early summer and fall of 2000 and which culminated in PWC's July and November 2000 reports. Pacific's characterization of PWC's work as "reaudits" is not only highly misleading, but it is also belied by PWC's own reports describing the parameters of its engagements.

PWC's July and November 2000 reports state explicitly that it did not conduct an "audit" of or render "an opinion on the procedures and systems implemented or revised based on Pacific management's responses to the Observations" in PWC's initial audit, but rather conducted agreed-upon procedures engagements in which it evaluated Pacific's assertions regarding the corrective steps Pacific allegedly took in response to the observations in PWC's initial audit.[146] Even a cursory examination of PWC's July and November 2000 reports reveals that PWC's work consisted, in large measure, of assessing the validity of Pacific's assertions that it revised its documented performance methods and procedures in response to PWC's initial audit. More fundamentally, PWC's agreed-upon procedures engagements were not designed to and did not cure the fundamental defects in PWC's initial audit, including, *inter alia,* the lack of any verifiable testing of the validity of Pacific's input and retail data.[147]

Nor can Pacific seek refuge in the data reconciliation process as proof of the accuracy and reliability of its performance data. Any suggestion that the data reconciliation process validated the accuracy of Pacific's data is belied by: (1) the extremely limited product, measurement and temporal scope of the data reconciliations; (2) the incompleteness of the data reconciliation process; and

[146] PricewaterhouseCoopers Report of Independent Accountants dated July 7, 2000 at 1 (Johnson Aff., Attach. E), PricewaterhouseCoopers Report of Independent Accountants dated November 10, 2000 at 1 (Johnson Aff., Attach. F).
[147] Toomey/Walker/Kalb Decl. ¶¶ 38-42.

(3) Pacific's own admissions during the data reconciliation process that its reported results are inaccurate.[148]

Additionally, because the data reconciliations upon which Pacific relies were conducted in 2000 and 2001, they cannot reasonably serve as reliable evidence of the accuracy of Pacific's current data. Significantly, data reconciliations that AT&T recently conducted with SBC in Texas revealed that SBC has improperly implemented the business rules governing the metrics, unilaterally created a disposition code, and inappropriately excluded data from its maintenance and repair results. SBC's failure to implement properly the business rules governing the metrics in Texas combined with the highly questionable disposition codes that are being used in California, illustrates the inherent risk of accepting at face value Pacific's reported results in California.[149]

Remarkably, however, even taking at face value Pacific's reported results – which is plainly unwarranted for the reasons discussed above – Pacific's own CLEC aggregate data show that it has failed to satisfy the parity and benchmark performance standards in any number of areas. Thus, for example, Pacific's own performance data show that Pacific fails to issue timely status notices to CLECs which are critical to a CLEC's ability to compete; and it has failed to perform at parity during the provisioning process.[150]

In the area of maintenance and repair, because AT&T only recently entered the residential service market in California, AT&T's recent commercial experience cannot reasonably serve as a basis upon which to assess fully Pacific's maintenance and repair performance. More generally, however, Pacific's own performance data show that Pacific is not providing CLECs with

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[148] *Id.* ¶¶ 43-45.
[149] *Id.* ¶¶ 46-54.
[150] *Id.* ¶¶ 55-79.

maintenance and repair services in substantially the same time and to the same degree of quality as those for its retail customers.

Invariably, when faced with its own performance data showing that it has failed to meet parity and benchmark standards, Pacific resorts to rationalizations and relies on promises of improved performance. However, Pacific's unfulfilled promises cannot and do not serve as probative evidence of its present compliance with its statutory obligations.

IV. THE CPUC HAS FOUND THAT PACIFIC HAS NOT FULLY IMPLEMENTED ITS RESALE OR LOCAL NUMBER PORTABILTY CHECKLIST OBLIGATIONS.

The CPUC concluded that Pacific has not fully implemented its checklist obligations with respect either to resale or to local number portability. With respect to resale of DSL transport services, the CPUC expressly found that Pacific has not satisfied checklist item 14 because it is improperly attempting to evade its resale obligations by spreading its DSL operations across two affiliates.[151] As the CPUC concluded, Pacific is engaged in the same corporate law shell game that the D.C. Circuit found unlawful in *ASCENT* v. *FCC*, 235 F.3d 662 (D.C. Cir. 2001). In *ASCENT*, the D.C. Circuit held that SBC and Ameritech could not avoid their Section 251(c) obligations with respect to advanced services merely by shifting those operations to an affiliate. *ASCENT*, 235 F.3d at 668. Similarly, Pacific cannot avoid its obligations to resell DSL transport services simply by shifting those operations among *two* affiliates, as it has done here. As the CPUC found:

> PBIS is not simply an ISP that combines DSL service with its own Internet service. Pacific affiliate PBIS receives DSL services from Pacific affiliate ASI, and those advanced telecommunications services become PBIS' retail services. Indeed, it is the affiliation between the

[151] *See CPUC 2002 271 Decision* 291-220 (explaining Pacific's deliberate decision formally to withdraw its retail DSL transport offer to avoid its resale obligation while still effectively providing DSL transport through affiliates); *see* Comments of AT&T Communications of California, Inc., In Opposition To Renewed Motion Of Pacific Bell Telephone Company For An Order That It Has Satisfied The Requirements Of The 14-Point Checklist in Section 271 Of The Telecommunications Act Of 1996, R. 93-04-003, et al., at 69-83 (filed August 24, 2001).

> three – Pacific, ASI, and PBIS – that effectively creates Pacific's provision of DSL transport at retail.[152]

As the CPUC put it (at 220), Pacific cannot lawfully "achieve with two affiliates what it cannot achieve with one."

Pacific's refusal to offer resale of DSL transport services is especially anticompetitive given Pacific's overwhelmingly dominant position in the California DSL market. The CPUC expressly found (at 220) that "Pacific's DSL market dominance in California is increasing while its competitors' DSL market share is decreasing," and that "the majority of California ratepayers have no provider choice other than Pacific for DSL access service." Because of the "unique role this service plays" in California, without resale of Pacific's DSL transport services, "competition in California will fester in the midst of the Pacific, ASI, and PBIS integration."[153]

In the past, the Commission has deferred this issue to other proceedings. However, it is less than clear whether the precise issue that the CPUC has raised – *i.e.*, whether a BOC is permitted to withdraw its retail DSL telecommunications services and structure its remaining DSL services in separate affiliates in order to avoid its Section 251(c)(4) resale obligations – will be squarely addressed in another proceeding. In all events, given the CPUC's findings that Pacific dominates the DSL market in California and that its actions have had a severely anticompetitive effect on DSL competition – indeed, the CPUC found that Pacific had not satisfied checklist item 14 – the Commission should not avoid the issue on the grounds that it will be decided elsewhere.

Item 11 of the competitive checklist requires a BOC to comply with the number portability regulations of the FCC pursuant to Section 251 of the Act.[154] Congress has defined number

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[152] CPUC Decision at 220; *see id.* at 219-20 ("PBIS' services are designed for, and sold to residential and business end-users," and "[w]ithout the DSL Transport Services provided to PBIS by ASI, PBIS could not reach its end users").
[153] *Id.*
[154] *See* 47 U.S.C. § 271(c)(2)(B)(xi).

portability as "the ability of users of telecommunications services to retain, at the same location, existing telecommunications numbers without impairment of quality, reliability, or convenience when switching from one telecommunications service to another."[155]

As the Commission has stated, "Congress enacted the number portability provisions of section 251 because the inability of customers to retain their telephone numbers when changing local service providers hampers the development of local competition."[156] Customers expect – and demand – that when they switch to another local exchange carrier they will be able to retain their existing telephone number and that the process will be transparent. Without such assurance, the customer would probably be unwilling to switch at all.[157]

Although Pacific claims "excellent" performance in the area of number portability,[158] the evidence shows that Pacific's processes and procedures with respect to stand-alone number portability orders do not currently satisfy its obligations under the checklist.[159] Specifically, Pacific's number portability processes and procedures have resulted in loss of dial tone for an unacceptably high number of customers ordering AT&T Broadband and AT&T Digital Link products, because they do not properly account for last-minute cancellations and rescheduling by those customers.[160]

Because AT&T Broadband and AT&T Digital Link local service require the installation of equipment by AT&T personnel at the customer's home or premises, AT&T makes every effort to schedule such installation at a time convenient to the customer. Despite these efforts, however, customers often make last-minute requests that their appointments be rescheduled or cancelled, for a

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[155] *Id.* § 153(30).
[156] *Second Louisiana 271 Order* ¶ 274.
[157] Willard Decl. ¶ 60.
[158] Application at 76.
[159] Willard Decl. ¶¶ 58-76.
[160] *Id.* ¶¶ 64-65, 72-76.

variety of reasons that are outside AT&T's control.[161] In such circumstances, pursuant to the procedures set forth in Pacific's CLEC Handbook, AT&T notifies Pacific of the need to reschedule or cancel a port as soon as the need to do so becomes apparent, but in no event later than 7 p.m. on weekdays, and 9 p.m. on Saturdays. AT&T provides such notification by telephone and facsimile to Pacific's Local Operations Center ("LOC").[162]

Under Pacific's stated procedures, upon receipt of a request for rescheduling, Pacific's LOC is supposed to fax the request to stop the scheduled porting to the Recent Change Machine Administration Center ("RCMAC"), which is then supposed to stop the work from occurring at the scheduled 10 p.m. time and create a jeopardy notice for the order (using the designation, "Customer Not Ready").[163] The procedures require AT&T to send a supplemental LSR the next business day to reschedule the number port unless the rescheduled date is more than 30 days later than the original due date, in which case AT&T must send a new LSR and cancel the original LSR.[164]

In practice, however, Pacific's processes have been inefficient, because Pacific has treated last-minute reschedulings and cancellations as rarities, rather than as the common occurrences that they actually are.[165] All too often the LOC has been slow in sending the fax request to the RCMAC or the RCMAC has not acted promptly to stop the disconnection. In such circumstances, the end-

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[161] *Id.* ¶ 63.

[162] *Id.* ¶ 73.

[163] *Id.* ¶¶ 73-74. Because AT&T prefers the number porting to occur at a time when the customer is least likely to be inconvenienced, in virtually all cases AT&T uses the default time of 10 p.m. both AT&T Broadband, although AT&T often specifies a particular Frame Due Time for business customers using AT&T Digital Link service because of the coordination required with such customers. *Id*. ¶ 20.

[164] *Id.* ¶ 74.

[165] The process described herein is Pacific's processes for handling requests for rescheduling or cancellation of LNP orders that occur after 1:00 p.m., which AT&T uses in all cases regardless of the time it submits such a request. *Id.* ¶¶ 72-74. Although Pacific provides an alternative process for requests submitted prior to 1:00 p.m., AT&T does not use that process because it is equally prone to delay and subsequent outages because CLECs using it must submit a supplemental LSR that falls out for manual processing by Pacific. *Id.* ¶¶ 70-71.

user's telephone phone number has been disconnected and the end-user has lost dial tone.[166] When the customer loses dial tone in such circumstances, Pacific generally needs to "build back" the customer's service – often charging the already-irate end-user for the work. If the problem is not discovered until after noon on the day following the due date, the customer must contact Pacific, and may be without dial tone for several days.[167]

Pacific's deficient process has caused considerable harm to AT&T and its customers. AT&T estimates that in some months, between 3 and 5 percent of its customers for AT&T Broadband and AT&T Digital Link have lost dial tone when they were switching from Pacific. Such outages not only have inconvenienced and angered customers, but in some cases caused customers to cancel their orders because the customer blamed the problem on AT&T.[168] The great irony, of course, is that these customers are going back to Pacific, *which is the very company that caused the problem in the first place.*

AT&T has repeatedly asked Pacific since mid-2000 to implement a mechanized process that avoids these dial tone losses by ensuring that a number will not be disconnected unless it has been activated by the CLEC.[169] Pacific however, did not agree until April 2001 to implement such a process. Even after it finally agreed to implement the process, Pacific was slow to do so. Pacific indicated that the new "mechanized NPAC check" would not be available for 12 to 18 months. True to its word, Pacific announced in October 2001 that the functionality was only scheduled for implementation in September 2002 – 17 months after it begrudgingly agreed to implement the

[166] *Id.* ¶ 75. Absent a last-minute cancellation or rescheduling by a customer, AT&T will send a transaction request to the Number Portability Administration Center ("NPAC"), which is the neutral third party administering local number portability in the United States. Once the transaction message has been sent, AT&T can "activate" the customer's number when the customer installation work has been completed. *Id.* ¶ 67. However, in the case of a last-minute cancellation or rescheduling, AT&T will not activate the number in the NPAC – resulting in the loss of dial tone if Pacific has erroneously disconnected the number from its switch at 10 p.m. that evening. *Id.* ¶ 75.

[167] *Id.* ¶ 75.

[168] *Id.* ¶¶ 64, 76.

process.[170] As the CPUC found, Pacific has never satisfactorily explained "why implementation of a mechanized enhancement to the NPAC check should take almost a year," since "a NPAC feed to [Pacific's] system already exists."[171]

The CPUC correctly found that the absence of a mechanized NPAC check constitutes a "critical barrier to entry for the CLECs," because under Pacific's processes "CLECs do not have certain knowledge of when Pacific will disconnect certain customers, and cannot maintain the integrity of these end-users' dial tones."[172] As a result, the CPUC concluded that until it implemented an adequate, mechanized NPAC check, Pacific could not be found in compliance with Item 11 of the checklist.[173]

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[169] *Id.* ¶ 77.

[170] *Id.* ¶¶ 78-79.

[171] *CPUC Decision* at 204, 293 (Finding of Fact 252).

[172] *Id.* at 204.

[173] *Id.* Pacific contends that implementation of a mechanized NPAC check is unnecessary to demonstrate compliance with checklist item 11, because : (1) its mechanized NPAC check goes "well beyond" industry standards; and (2) the Commission's recent order in the Virginia arbitration proceeding holds that a BOC is not required to await NPAC confirmation prior to porting. Application at 75-76; E. Smith Aff. ¶ 18 & n.16. Pacific is wrong on both counts. The Commission has made clear that a BOC's compliance with industry standards – or even exceeding industry standards – cannot be equated with compliance with the checklist. *See, e.g., Second Louisiana 271 Order* ¶ 137 ("compliance with industry standards may not meet the statutory requirement of providing nondiscriminatory access to OSS functions. . . . In other words, a BOC must provide nondiscriminatory access to its OSS functions irrespective of the existence of, or whether it complies with, industry standards"); *South Carolina Order* ¶ 121 (holding that BellSouth must provide electronic error notification notwithstanding absence of industry standards, and noting that Commission has "previously rejected arguments that a lack of industry standards excuses an incumbent LEC from meeting its obligation to provide nondiscriminatory access to OSS functions"). Pacific's reliance on the Virginia arbitration order also is misplaced. There, the Commission found that Verizon was not required to implement a mechanized NPAC check because Verizon had shown that "costly changes would be necessary to implement the requested functionality" (particularly since Verizon's ordering and provisioning systems do not currently interact with the system that receives NPAC "activate" messages), and because of the lack of evidence that such changes were warranted. *See Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration*, CC Docket Nos. 00-218, 00-249, and 00-251, Memorandum Opinion and Order released July 17, 2002, ¶¶ 563-566. Here, by contrast, Pacific has presented no evidence that implementation of a mechanized NPAC check would be extremely costly or otherwise unreasonably burdensome. Unlike Verizon's systems, Pacific's ordering and provisioning systems currently interact with its system that receives NPAC activate messages. Willard Decl. ¶ 79. Finally, unlike the record in the Virginia arbitration proceeding, the evidence here shows that the existing manual processes of Pacific are inadequate to prevent loss of dial tone and, therefore, that a mechanized process is warranted.

Pacific appears finally to have implemented the mechanized NPAC check on September 30, 2002.[174] Although AT&T hopes that this new functionality will finally put to rest the outage problems that Pacific's processes previously caused, the implementation of the functionality is so recent that it would be premature to conclude that the functionality is adequate. Because of the lack of evidence regarding the commercial performance of the new functionality, the Commission – like the CPUC – should conclude that Pacific has not satisfied Item 11 of the checklist.[175]

V. PACIFIC HAS FAILED TO DEMONSTRATE THAT IT AND ITS SECTION 272 AFFILIATE WILL OPERATE IN ACCORDANCE WITH SECTION 272 IF GRANTED INTERLATA AUTHORITY.

"As a pre-condition to entry under section 271,"[176] Pacific and its section 272 affiliate must present evidence, not "[p]aper promises," that establishes they will comply "with the requirements of section 272."[177] Such a showing of "compliance with section 272 is 'of crucial importance' because the structural, transactional, and nondiscrimination safeguards of section 272 seek to ensure that BOCs compete on a level playing field."[178]

In light of the numerous and substantial problems identified in a recently completed audit of Pacific (conducted on behalf of the CPUC), Pacific and its section 272 affiliate have not met their burden of establishing that they will comply with section 272.[179] That Pacific Audit Report concluded (among other things):

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[174] Willard Decl. ¶ 83.

[175] The CPUC, recognizing that implementation of the mechanized NPAC check without sufficient evidence of its operation in commercial production, required that Pacific to submit not only proof of implementation, but also 30 days of operational data to verify implementation. *CPUC Order* at 207, 318.

[176] *Non-Accounting Safeguards Third Order On Reconsideration* ¶ 2.

[177] *Michigan 271 Order* ¶ 55; 47 U.S.C. § 271(d)(3)(B)

[178] *Texas 271 Order* ¶ 395 (quoting Michigan 271 Order ¶ 346).

[179] *Regulatory Audit of Pacific Bell For The Years 1997, 1998, and 1999*, Overland Consulting (hereinafter "Pacific Audit Report"), issued Feb. 21, 2002 and supplemented May 8, 2002 and June 20, 2002. For the convenience of the Commission, the Audit Report's Executive Summary, Chapter 2 (reflecting audit background and scope), and second Supplemental Report are attached as Attachment 2. The remainder of the voluminous Pacific Audit Report is available at www.cpuc.ca.gov/static/industry/telco/supplement+report+on+and+of+pacific+bell.htm.

- that Pacific had underreported net regulated operating income to the CPUC by approximately $2 *billion* over the three-year period reviewed (1997-1999), allowing Pacific to avoid paying refunds to California consumers of approximately $350 million;
- that Pacific and its affiliates had engaged in improper cross-subsidization, allowing Pacific to substantially understate its operating income, by, for example, transferring Pacific CPNI for use by affiliates without reimbursement to Pacific, and paying SBC $400 million annually for Pacific's use of the SBC name in California despite the transaction providing no apparent benefits to Pacific;
- that Pacific "did not always comply with CPUC affiliate transactions rules," and "[i]nternal accounting controls governing certain affiliate transactions were inadequate;" and
- that Pacific had obstructed completion of the audit, imposing restrictions on release of data the auditors deemed necessary to complete their work, and denying (or delaying) the auditors access to such information or data.

Pacific fails even to mention these audit conclusions in its application, let alone establish that this Commission may still conclude that Pacific will comply with the requirements of section 272 despite its utter failure to comply with its overlapping accounting obligations under California law.

In addition, Pacific has chosen to defy the CPUC's joint marketing rules, which precludes any finding, as required, that Pacific will meet the joint marketing requirements imposed by § 272(g). The CPUC joint marketing rules, reached after years of proceedings and fact gathering by the CPUC, are fully consistent with both § 272(g) and the Commission's prior joint-marketing rulings. Under these circumstances, the Commission cannot properly find that Pacific and its section 272 affiliate will comply with section 272 while they defy the CPUC's overlapping rulings on these very issues.

Instead of even discussing these important issues, Pacific's application relies on the fact that the Commission has found, in past applications from different states, that SBC and its section 272 affiliate will comply with section 272. Pacific's position ignores the Commission's obligation to review and assess each section 271 application independently, based on its analysis of the unique facts and circumstances presented by the particular application. On the record presented in California, no finding can be made based on Pacific's "paper promises" that it will comply with the requirements of § 272. Pacific's failure to meet its burden of establishing § 272 compliance provides an "independent ground[] for denying [this] application."[180]

A. Pacific Has Failed To Establish That It Will Not Improperly Subsidize The Operation Of SBCS.

The section 272 requirements are "designed, in the absence of full competition in the local exchange marketplace, to prohibit anticompetitive discrimination and cost-shifting."[181] Among the core concerns that section 272 is intended to meet is that the BOC will subsidize the operation of its section 272 affiliate by recovering the affiliate's costs from the BOC's local and exchange access service customers.[182] Thus, section 272 requires that the BOC and section 272 affiliate keep separate books and records, operate independently with separate employees, officers, and directors, and conduct all transactions on an arms length, non-discriminatory basis. *See* 47 U.S.C. § 272(b), (c)(1).

Pacific pledges compliance with each of these requirements, relying heavily on the fact that the Commission previously has found that SBC and its section 272 affiliate, Southwestern Bell Communications Services ("SBCS"), had met their burden of establishing that they will operate in conformity with these section 272 requirements.[183] Pacific's mere paper promises of compliance are insufficient to meet its burden, however, especially in light of the recently completed Pacific Audit Report. As noted above, this audit uncovered blatant subsidization by Pacific of its nonregulated affiliates, including SBCS. Pacific does not even acknowledge this subsidization, let alone attempt to establish that this subsidization has been corrected and that procedures have been put in place to prevent their recurrence.

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[180] *New York 271 Order* ¶ 402.

[181] *Non-Accounting Safeguards Order* ¶ 9.

[182] "Congress ... enacted section 272 to respond to the concerns about anticompetitive discrimination and cost-shifting that arise when a BOC enters the interLATA services market in an in-region state in which the local exchange market is not yet fully competitive." *Non-Accounting Safeguards Second Order On Reconsideration* ¶ 5.

[183] *E.g. Arkansas/Missouri 271 Order* ¶ 257.

Specifically, this 2002 Pacific Audit Report uncovered that, beginning in 2000, Pacific began paying SBC "more than $400 million annually for 'use of the corporate name.'"[184] Assuming these payments have continued to date, Pacific will have paid SBC over $1 billion for its use of the SBC name in California. It is self-evident that use of the SBC name has no positive value for Pacific in California, given Pacific's longtime dominance of that market and widespread name familiarity.[185] *See* Pacific Audit Report, S12-5 (June 20, 2002) (noting that value Pacific derives from use of SBC name "is not immediately evident."). Instead, it is SBCS, the section 272 affiliate, not Pacific, that has directly benefited from Pacific's use of the SBC name, by increasing familiarity with its brand (and hence brand value) with California consumers through its association with Pacific. This charge for the use of the SBC brand thus is a cost that SBCS, not Pacific's local customers, should bear. Having Pacific pay a $400 million annual fee for use of the SBC name thus amounts to a classic case of improper cross-subsidization of SBCS.

In addition, the Pacific Audit Report found that Pacific has "effectively transferred" its CPNI to SBC's centralized marketing services affiliate, but Pacific "has not been compensated for the transfer" of CPNI.[186] The tremendous value of Pacific's CPNI is self evident. As the Pacific Audit Report noted, Pacific's CPNI was "developed over several decades" and "funded by regulated telephone company customers."[187] Such CPNI is uniquely valuable, because "Pacific Bell is the only company with a nearly complete database of customers in the California telecommunications market areas its serves" as a result of its previous "exclusive franchise to provide local exchange in these areas." Indeed, as the Audit Report recognized, "if SBC considers the use of its name (something that lacks clearly definable benefits) to be worth $400 million annually to Pacific Bell alone," then

[184] Pacific Audit Report, S12-1 (June 20, 2002).
[185] Pacific Audit Report, at S12-6, ¶ 2 (June 20, 2002).
[186] Pacific Audit Report, S12-1 (June 20, 2002).
[187] Pacific Audit Report, S12-7, ¶ 4 (June 20, 2002).

"Pacific Bell's customer database (which has more definable benefits) may be worth at least as much to SBC and its affiliates taken together."[188]

The anticompetitive impact of such unpaid-for access to Pacific's CPNI cannot be overstated. The high customer acquisition costs faced by CLECs is a significant barrier to their market entry and expansion. Yet according to the Audit Report SBCS is able to obtain Pacific CPNI without cost, giving it a substantial competitive advantage. Such CPNI abuses by Pacific are all the more significant given the blatant abuse reflected in previous lawsuit against Pacific by AT&T, MCI, and Sprint that is cited in the CPUC decision.[189] As the CPUC recognized, this earlier action "also involved [Pacific's] unfair use of customer contacts generated ... by the provision of local exchange telephone service."[190] The record before this Commission thus reflects repeated CPNI abuses by Pacific.

In light of such significant and repeated instances of improper cross-subsidization by Pacific, no finding of section 272 compliance can be made. Pacific's application ignores this issue, simply asserting that its accounting safeguards are sufficient to preclude such improper cross subsidization.[191] Such assertions are wholly insufficient, however, where an audit report issued this year establishes beyond question that Pacific has engaged in improper subsidization of SBCS. Pacific does not even acknowledge this problem, let alone provide the Commission with concrete proof that it (i) has remedied these abuses, and (ii) has established visible and enforceable safeguards to prevent their recurrence. Without such proof, there is no factual basis to find that Pacific will comply with section 272.

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[188] Pacific Audit Report, S12-7, ¶ 4 (June 20, 2002).
[189] *CPUC 2002 271 Decision* at 256.
[190] *CPUC 2002 271 Decision* at 256 (internal quotations omitted).
[191] *E.g.* Henrichs Aff. ¶ 13-14.

B. Pacific And SBCS Have Not Established That Their Internal Controls On Affiliate Transactions Are Sufficient To Insure That Section 272 Requirements Are Met.

The Pacific Audit Report also concluded that Pacific's and SBC's internal accounting controls governing "affiliate transactions processes were inadequate."[192] The auditors "found a number of control weaknesses" in the accounting systems Pacific and SBC had in place "to identify and bill affiliate services." In particular, the auditors determined that such "[i]nternal accounting controls were weakest with respect to the new shared services affiliates, SBC Services and SBC Operations."[193] Further, the auditors concluded that "SBC and its subsidiaries did not always comply with affiliate transaction requirements."[194] For example, "SBC was unable to provide FCC-mandated documentation supporting the allocation of employee time among subsidiaries," "affiliates did not supply Pacific Bell with sufficient information to properly direct affiliate charges to the correct accounts," and the data available was "insufficient to determine whether the charges to Pacific Bell were reasonable, consistent with FCC Part 64 attributable cost principles, or properly charged to customer (above-the-line), rather than shareholder (below the line) accounts."[195]

Again, Pacific's application ignores these findings. Instead, Pacific simply asserts that its identified controls are adequate to ensure that section 272's accounting requirements are met and attaches its "Operating Practice" manual.[196] Given the Audit Reports directly contrary findings, that is plainly insufficient. Until Pacific demonstrates that it both has corrected these problems and has

[192] Pacific Audit Report, at 1-3.
[193] *Id.* at 1-8.
[194] *Id.* at 1-10.
[195] *Id.* at 1-10.
[196] *See* Henrichs' Aff., ¶¶ 44-58.

implemented changes to prevent their recurrence, there is no factual basis for the Commission reasonably to conclude that Pacific has satisfied its burden under section 272.[197]

C. Pacific And SBCS Have Not Established That They Will Engage In Transactions Only On An Arms Length Basis.

Section 272(b)(5) requires that "all transactions" between Pacific and SBCS be "on an arm's length basis." As an Administrative Law Judge for the Minnesota Commission recently pointed out (concerning a section 272 compliance review of Qwest), the failure to engage in arm's-length transactions as required by section 272(b)(5) can seriously damage competition, because, for example, transaction pricing for a BOC and its section 272 affiliate ultimately has a net zero effect on the financial returns to their joint owner, but has a serious impact on competing carriers because of the section 272(c) obligation to offer the same terms to competitors.[198]

Pacific and SBCS cannot satisfy this "arm's length" requirement while – as appears from the section 271 application and the Pacific Audit Report – many of their core operations are performed by the same SBC affiliates. As the Minnesota ALJ concluded: "Entities dealing with each other cannot depend upon the same source for legal services, public policy analysis, and financial consulting with respect to transactions occurring between the two entities and remain at "arm's length" in a transaction."[199] The reason is plain. A transaction cannot be "arm's length," as required by section 272(b)(5), if the key personnel on both sides of the transaction "negotiation" are the same.

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[197] The Pacific Audit Report made clear that effective internal controls are especially important to guard against improper cross-subsidization among affiliates because of SBC's recent reorganizations: "SBC's reorganization of major telephone company marketing, network and administrative functions into corporate shared services subsidiaries creates a significant potential for affiliate cross subsidies in the form of uncompensated or under-compensated transfers of intellectual property, customer and network data, telco operating know how and trade secrets." Pacific Audit Report, at 1-12.

[198] *See* Commission Investigation Into Qwest's Compliance with the Separate Affiliate Requirements of the Telecommunications Act of 1996 (Section 272), Minnesota Pub. Util. Comm., Findings of Fact and Conclusions of Law and Recommendations, PUC Doc. No. P-421/C1-01-1372 ("Minnesota ALJ Findings"), ¶¶ 83-84 (Mar. 14, 2002).

[199] *See* Minnesota ALJ Findings, ¶ 79.

Here, SBCS acknowledges that many, if not all, of such key operations are obtained from SBC shared services affiliates, including "legal and regulatory" work, "financial operations," "product development," "affiliate transactions," and "procurement."[200] The Pacific Audit Report contains telling evidence that Pacific also intends to depend heavily on such shared services. As the Audit Report found: "Pacific Bell's regulated telephone company functions, employees and proprietary information are being transferred to corporate 'shared services' affiliates. Several thousand telco employees were transferred at the end of 1999 alone."[201]

Under these circumstances, no reasonable basis exists to conclude that Pacific and SBCS will comply with section 272(b)(5)'s arm's-length transaction requirement. To the contrary, the only evidence in the record is that many, if not most, of these transactions will be planned, overseen, and executed by employees of the same shared services affiliates. Such evidence precludes any rational finding that Pacific has demonstrated that it and SBCS will enter into transactions using separate employees who conduct such transactions on an arms length, non-discriminatory basis. See 47 U.S.C. § 272(b)(5) & (c)(1).

D. Pacific Cannot Establish That It Will Comply With The Audit Requirements Of Section 272(d) Given The CPUC Auditors' Finding That Pacific Obstructed The Completion Of Their Recent Audit.

Section 272(d) requires that BOCs receiving interLATA authority "shall obtain and pay for a joint federal/State audit every two years conducted by an independent auditor to determine whether such company has complied with [section 272]." The Commission has recognized "the critical role the biennial audit will play in ensuring that the [accounting] safeguards are working,"[202] and BOC applicants frequently have relied on section 272(d) as support for their applications, arguing that their pledges of section 272 compliance will be tested by such audits not too long after they enter the

[200] Yohe Aff., Attachment A.
[201] Pacific Audit Report, at 1-3.

interLATA market.[203] Nevertheless, the required determination that a BOC will comply with section 272(d) has not been challenged in comments or discussed by the Commission in the context of a section 271 application. Here, however, the stark findings of the CPUC-sponsored audit earlier this year that Pacific had obstructed the completion of that audit precludes any finding that Pacific will comply with section 272(d). In light of these audit findings, which Pacific ignores in its application, Pacific cannot establish that it will comply with section 272(d) through its bare promises.

The CPUC-sponsored audit, which was "the first comprehensive regulatory audit of Pacific Bell" by the CPUC since 1990, was undertaken with the full authority of state law, and was overseen by the CPUC's Telecommunications Division.[204] The Pacific Audit Report was issued less than nine months ago, in February 2002, with supplements issued during May and June 2002. Given that this CPUC-sponsored audit is similar in nature to what is anticipated under section 272(d), and is close in time to Pacific's current application, it is the best evidence available on the question of whether Pacific will comply with section 272(d).[205]

The Pacific Audit Report provides a powerful evidentiary record that precludes any rational reliance on Pacific's mere paper promises in its application that it will comply with section 272(d).[206] This Audit Report identifies a series of efforts by Pacific to interfere with the audit, which substantially delayed its completion and made it impossible for the auditors to meet all the audit objectives. For example, the Audit Report concludes that "Pacific imposed restrictions on the data it considered to be relevant and within the audit scope."[207] The Audit Report also finds that Pacific

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[202] *Accounting Safeguards Order* ¶ 197.

[203] *E.g., New York 271 Order* ¶ 413.

[204] PacBell Audit Report, at 2-1 – 2-2; Calif. Pub. Util. Code, § 314.5.

[205] *See Michigan 271 Order* ¶ 347 ("[W]e look to past and present behavior of the BOC applicant as the best indicator of whether it will carry out the requested authorization in compliance with the requirements of section 272.").

[206] *See* Henrichs Aff. ¶¶ 41-42.

[207] Pacific Audit Report, 2-3.

refused to answer certain data requests and imposed "time periods that requested data could cover."[208] The Audit Report recounts numerous instances where Pacific's "data responses were incomplete or not responsive," or simply unanswered entirely.[209] As a result of Pacific's numerous obstructions and refusals, the auditors were prevented "from obtaining sufficient data to develop conclusions in some areas."[210]

In addition, on numerous occasions Pacific failed to respond to data requests in anything approaching a timely fashion, leading the auditors to conclude that Pacific's "inability and/or unwillingness to provide data within a reasonable period after receiving a written request [with a response time averaging over two months rather than the target time of 10 days] degraded the efficiency of the audit and caused it to consume more calendar time and effort than originally budgeted."[211] As a result, the audit required an additional sixth months to complete, even without reaching each of the audit objectives.[212]

Given this recent record of obstruction and delay by Pacific in the face of a lawful audit performed on the behalf of a regulatory authority, there is no evidentiary basis to support a conclusion, as required, that Pacific will comply with section 272(d). Instead, the only evidence in the record is evidence of Pacific's obstruction and delay of a comparable audit proceeding.

E. Pacific's Defiance Of The CPUC's Joint-Marketing Requirements Precludes Any Finding That It Will Comply With The Joint Marketing Restrictions Of Section 272(g).

Following years of hearings and data collection, the CPUC has imposed certain limited restrictions and guidelines on Pacific and its section 272 affiliate concerning their joint-marketing of

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[208] *Id.*
[209] *Id.* at 2-4.
[210] *Id.* at 1-4.
[211] *Id.* at 2-3 – 2-4.
[212] *Id.* at 1-4.

the affiliate's interLATA services. These CPUC joint-marketing requirements are based on this Commission's previous orders concerning joint marketing, and are fully consistent with both the Commission's past orders and section 272(g). Yet Pacific has defied the CPUC's joint marketing rules, suggesting that the CPUC is precluded from adding joint-marketing requirements that have not already been imposed by this Commission's orders.[213] And in its section 271 application, Pacific pointedly refuses to commit to comply with the CPUC guidelines. Instead, Pacific, without elaboration, commits only that "it will conduct any joint marketing in a manner consistent with the FCC's decision [in the *South Carolina 271 Order*]."[214] No finding properly can be made that Pacific and its section 272 affiliate will comply with the joint marketing requirements of section 272(g) when Pacific defies CPUC's restrictions that are fully consistent with section 272(g) and this Commission's rulings.

In its *South Carolina 271 Order*, the Commission held that, under section 272(g), BOCs may mention their section 272 affiliate, apart from including that affiliate in a list of available interexchange carriers, so long as they also contemporaneously "offer to read, in random order, the names and, if requested, the telephone numbers of all available interexchange carriers."[215] The Commission has declined to become more involved in evaluating a BOCs joint-marketing plans under section 272(g) in the context of a section 271 application.[216] But the Commission has never suggested that the state commissions are precluded from providing more detailed rules and guidance

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[213] *See* CPUC 2002 271 Decision, at 267; Pacific Bell Telephone Company's (U 1001C) Reply To The Opposition Filings On Public Utilities Code Section 709.2 Requirements, CPUC, Rulemaking on the Commission's Own Motion To Govern Open Access To Bottleneck Services and Establish a Framework for Network Development of Dominant Carrier Networks, R.93-04-003, at 32 (Sept. 13, 2001).

[214] Yohe Aff., ¶ 46.

[215] *South Carolina 271 Order* ¶ 239; *see also Second Louisiana 271 Order* ¶ 357 (same). The Commission's *South Carolina 271 Order* reversed its decision just four months earlier in the *Michigan 271 Order*, which had held that *any* discriminatory identification of the BOCs section 272 affiliate during inbound calls for service was not authorized as joint marketing under section 272(g), reasoning that such discriminatory identification is "inconsistent on its face" with the equal access requirements expressly continued by section 251(g). *Michigan 271 Order* ¶ 375.

concerning the appropriateness of a BOC's joint marketing efforts, as long as such rules are consistent with section 272(g) and the Commission's rules. Here, there can be no serious dispute that the CPUC's joint marketing rules are fully consistent with both section 272(g) and the Commission's orders.

As described in the CPUC's recent decision, the CPUC, like the Commission, allows Pacific to market its affiliate's long distance service during inbound customer calls, and also allows Pacific to identify its long distance affiliate separate from reading a list of available IXCs.[217] To "protect customers from abusive marketing practices," however, the CPUC has elaborated on these joint marketing rules by requiring that Pacific first "resolve a customer's service request" and "seek permission to present marketing information" from the customer before engaging in any such joint marketing efforts.[218] And when taking orders for new service, Pacific may not separately market its affiliate's long distance services (although it can separately identify its affiliate) until first asking customers if they have already selected a long distance provider, and must "respect the selection of the customer should the customer select another long-distance provider."[219]

These (and other) marketing rules imposed on Pacific are in no way inconsistent with the BOCs' joint marketing authority under 272(g), which, as the Commission has long recognized, must be balanced against the BOCs' continuing equal access obligations under section 251(g).[220] Nor are such CPUC marketing rules inconsistent with the Commission's prior orders, which essentially have provided only that a BOC may market its long distance service during inbound calls and "may mention" its long distance affiliate outside the context of a list of IXCs (so long as the BOC

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[216] *See South Carolina 271 Order* ¶ 236 (stating that the Commission will not require BOCs to submit proposed marketing scripts for review in connection with section 271 applications).

[217] *See CPUC 2002 271 Decision*, at 251; *South Carolina 271 Order* ¶ 239.

[218] *CPUC 2002 271 Decision*, at 256-57.

[219] *Id.* at 251.

contemporaneously offers to read from a list of possible IXCs).[221] The Commission's prior orders do not suggest that a state regulatory commission may not provide further guidelines on the appropriate timing and sequencing of such marketing efforts during inbound calls, or concerning unduly aggressive marketing practices (such as marketing an affiliate's interLATA services even when customers have made up their minds on their preferred provider).

Given that the CPUC's joint marketing rules are fully consistent with section 272(g) and this Commission's orders, no finding can be made that Pacific will comply with section 272(g) unless it demonstrates that it will comply with the CPUC's marketing guidelines. Otherwise, the CPUC's recognized authority to further the Act's purposes by implementing consistent rules would be seriously undermined. Far from demonstrating its compliance with the CPUC's guidelines, Pacific has not even committed to comply with the CPUC rules. Instead Pacific suggests that it will defy the CPUC's rules based on its view that only this Commission can impose joint marketing requirements.[222] On this record, the Commission cannot properly find that Pacific will comply with section 272(g).

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[220] *E.g. Non-Accounting Safeguards Order* ¶ 292; South Carolina 271 Order ¶¶ 238-39.

[221] *See South Carolina 271 Order* ¶ 239.

[222] *See, e.g.,* Pacific Bell Telephone Company's (U 1001C) Reply To The Opposition Filings On Public Utilities Code Section 709.2 Requirements, CPUC, Rulemaking on the Commission's Own Motion To Govern Open Access To Bottleneck Services and Establish a Framework for Network Development of Dominant Carrier Networks, R.93-04-003, at 13, 31-32 (Sept. 13, 2001). Even if Pacific's preemption claim had any merit (which it does not), this Commission has made clear that the proper course is not for PacBell to defy the CPUC and violate the state regulatory requirements based on its own views of federal preemption. Instead, if PacBell wishes to pursue this issue, it can petition this Commission to review the CPUC's requirements and determine (with the input of all interested parties, including the CPUC) if the rulings are consistent with federal law. *See Accounting Safeguards Order* ¶ 45 (directing that carriers who believe states have imposed accounting rules that are inconsistent with section 272 seek declaratory judgment from FCC, which claims will be considered on a case by case basis).

In sum, Pacific and its section 272 affiliate have not met their burden of showing that they will operate in accordance with section 272 if granted in-region interLATA authority. This application may be rejected on that basis alone.[223]

VI. PACIFIC'S ENTRY INTO THE INTERLATA MARKET IS NOT CONSISTENT WITH THE PUBLIC INTEREST

Even if the Commission could rationally find that Pacific had fully implemented its obligations under the competitive checklist, or that Pacific had demonstrated that it would comply with section 272, the record here precludes any finding that granting Pacific's application is "consistent with the public interest, convenience and necessity."[224] The "public interest" prong of Section 271 requires the Commission to "ensure that no other relevant factors exist that would frustrate the congressional intent" that the local exchange market be fully and irreversibly open to competition.[225]

Although, with persistent pressure from the CPUC, Pacific has taken significant steps to open its local markets, the CPUC's recent report on the state of competition in California conclusively shows that Pacific maintains an overwhelming share of California's local exchange market. The progress Pacific has made toward opening up its markets reflects not only the close oversight of the CPUC, but also Pacific's incentive under section 271 to comply with the Act. If that incentive is

[223] *See New York 271 Order* ¶ 402; *Michigan 271 Order* ¶¶ 346-348.

[224] 47 U.S.C. § 271(d)(3)(C).

[225] *Kansas/Oklahoma 271 Order* ¶ 267; *Arkansas/Missouri 271 Order* ¶ 124 (recognizing that "the overriding goal" of the public interest analysis "is to ensure that nothing undermines the conclusion ... that the markets are open to competition"). The Supreme Court has explained that the statutory term "public interest" "take [its] meaning from the purposes of the regulatory legislation." *NAACP* v. *FPC*, 425 U.S. 662, 669 (1976). As the Commission has held, Congress adopted Section 271 in order to assure that BOCs could not provide long distance service at a time when their local monopolies would give them an unfair advantage over long distance competitors in, *inter alia*, providing "combined packages" of local and long distance service to customers who desire "one-stop shopping." Memorandum Opinion and Order, *AT&T* v. *Ameritech*, 13 F.C.C. Rcd. 21438, ¶¶ 5, 39 (1998), *aff'd sub nom. U S WEST* v. *FCC*, 177 F.3d 1057 (D.C. Cir. 1999). If, by contrast, long-distance entry were allowed before other carriers could provide competing combined packages, it would "threaten competition" in both the local and the long-distance markets by granting the BOC a monopoly in the provision of such combined services. *Id.* ¶ 5.

prematurely removed, Pacific's cooperation in opening the local market will evaporate, harming competition and consumers in local and long distance markets alike.

Most significantly, the CPUC concluded just weeks ago that the public interest would not be served by Pacific's entry into the in-region interLATA market at this time. Following a 5-year investigation, the CPUC concluded that Pacific could not satisfy the public interest components of California's Costa Bill (Calif. Pub. Util. Code § 709.2). Specifically, the CPUC concluded that Pacific was unable to establish (as required by the Costa Bill) that it would not engage in anticompetitive behavior if granted interLATA authority, that it had not engaged in, and would not engage in, improper cross subsidization of the in-state interLATA services, and that Pacific's entry into the interLATA market would not harm competition in the in-state interLATA markets.[226] In sum, the CPUC concluded that "Pacific's less than complete progress has given California technical, not actual, local telephone competition," and foresaw "the harm to the public harm to the public interest if actual competition in California maintains its current anemic pace, and Pacific gains intrastate long distance dominance to match its local influence."[227]

The CPUC's conclusion that Pacific's entry into the interLATA market is not consistent with the public interest in California given the current "anemic" status of competition in California and Pacific's prior anticompetitive conduct is well supported and compels the same conclusion before this Commission. Allowing Pacific's entry into the interLATA market now will endanger the continuing development of local competition during this critical period because Pacific will lose the current strong incentive to forego additional anticompetitive conduct. At the same time, such a grant would endanger the already competitive interLATA market by giving Pacific the ability to undermine competition in this market, through its continuing role as the Preferred Interexchange Carrier (PIC)

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[226] *CPUC 2002 271 Decision*, at 252-267.

administrator, its joint marketing authority, and its ability otherwise to leverage its market power in the local market. Finally, granting Pacific in-region interLATA authority offers few, if any, benefits to California consumers, given Pacific's recent statement to investors that it intends to offer interLATA services (where authorized) at prices that match, or exceed, existing rates of competing IXCs.

In fact, since September 2001, when the CPUC closed the record to new evidence in its section 271 proceeding, substantial additional evidence has come to light that further supports the determination that Pacific's entry into the interLATA market would not be consistent with the public interest. Most significantly, the Pacific Audit Report, discussed above, which was released in February 2002 and supplemented this past summer, identifies a host of substantial anticompetitive and illegal conduct by Pacific. For example, the Audit Report concluded that Pacific had underreported (under CPUC accounting rules) regulated operating income by approximately $2 billion during the three-year period reviewed, and thus avoided refunding approximately $350 million to its California customers.[228] The Audit Report also concluded that Pacific had engaged in improper cross-subsidization, using income from its local market customers to subsidize nonregulated Pacific affiliates, such as by paying SBC $400 million *annually* for the use of the SBC name (which plainly has no value to Pacific in California but had substantial value to SBC's section 272 affiliate, SBCS), and by receiving no reimbursement from SBC for the use of Pacific's valuable CPNI.[229] Finally, the Audit Report established Pacific's unwillingness to cooperate with basic, lawful oversight efforts,

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[227] *CPUC 2002 271 Decision*, at 263, 267.
[228] Pacific Audit Report, 1-2 through 1-3.
[229] *See* Pacific Audit Report, S12-1, S12-7, S12-5 (June 20, 2002).

concluding that Pacific had obstructed completion of the CPUC-sponsored audit by repeatedly delaying or refusing compliance with necessary and basic audit requests.[230]

This strong and recent evidence of Pacific's gross violations of CPUC's regulations and defiance of regulatory authority is strong evidence that its entry into the interLATA market at this time would be inconsistent with the public interest. As the Commission has stressed: "Because the success of the market opening provisions of the 1996 Act depend, to large extent, on the cooperation of the incumbent LECs, including the BOCs, with new entrants and good faith compliance by such LECs with their statutory obligations, evidence that a BOC has engaged in a pattern of discriminatory conduct or disobeying federal and state telecommunications regulations would tend to undermine our confidence that the BOC's local market is, or will remain, open to competition once the BOC has received interLATA authority."[231]

For these reasons, discussed further below, no finding can properly be made that Pacific's entrance into the interLATA market would be consistent with the public interest, and thus Pacific's application should be denied.

A. Pacific's InterLATA Authorization Cannot Properly Be Found In The Public Interest Given The CPUC's Determination That Pacific Does Not Satisfy The Overlapping Requirements Of The Costa Bill.

California's Costa Bill (Calif. Pub. Util. Code § 709.2), enacted in 1994, requires that the CPUC evaluate whether Pacific's entry into the interLATA market is consistent with the public interest. Specifically, the Costa Bill requires, among other things, that the CUPC evaluate (i) whether Pacific has engaged in anticompetitive behavior, (ii) whether there has been improper cross-subsidization of interLATA telecommunications service, and whether there is a "substantial

[230] *See* Pacific Audit Report, 1-4, 2-3 through 2-4.
[231] *Michigan 271 Order* ¶ 397.

possibility of harm" to the competitive intrastate interexchange telecommunications markets.[232] The requirements of the Costa Bill, therefore, substantially overlap with, and complement, the public interest requirement under section 271(d)(3)(C). Given this overlap, the CPUC's determination here, after lengthy investigation, that Pacific did not meet *any* of these three elements of the Costa Bill is compelling evidence that Pacific's entry into the interLATA market at this time is not in the public interest under section 271(d)(3)(C).

Remarkably, Pacific claims that the CPUC's public interest determination is "irrelevant" to this Commission's parallel examination under section 271(d)(3)(C). Yet this Commission frequently has recognized the important role played by state commissions in the section 271 application process, especially given "the state commissions' knowledge of local conditions and experience in resolving factual disputes."[233] The CPUC's analysis, therefore, is deserving of significant deference from the Commission in making its own independent public interest determination under section 271(d)(3)(C).[234]

Moreover, as detailed further below, the CPUC's determination is founded in tangible, substantial evidence of anticompetitive misconduct by Pacific, including significant and improper cross-subsidization. When these facts are coupled with the CPUC's recognition that local competition in California was "technical, not actual," there can be no fair challenge to the CPUC's

[232] Calif. Pub. Util. Code, § 709.2(c)(2)-(4).

[233] *Michigan 271 Order* ¶ 30.

[234] Pacific's suggestion that the California PUC lacks "any authority" (Pacific Br. 94) to enforce state-law requirements governing intra-State interLATA services such as those addressed by the CPUC in connection with Section 709.2 is both incorrect and beside the point. The Commission has recognized that Section 271 does not divest States of "authority to enforce obligations relating to a BOCs' provision of interstate interLATA service." *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd. 21,905, 21,929 n.97 (1996); s*ee also* 1996 Act, sec. 601(c). The purported conflict between state and federal law that Pacific anticipates is in any event premature, because Pacific's federal 271 application should be denied for all of the reasons stated herein. The question Pacific poses would become ripe only in the event this Commission were to grant Pacific's application before Pacific has met the requirements of § 709.2.

conclusion that Pacific's current entry into the interLATA market is premature, and would threaten competition in both the local and long distance markets in California.

B. Pacific's Repeated And Substantial Violations Of State and Federal Regulations Destroy Any Confidence That Pacific's Local Market Is Open To Competition And Will Remain Open.

Pacific has failed "to cooperate in opening its network to competitors" by engaging in a pattern of "anticompetitive conduct" that precludes any finding that Pacific's local market is open to competition and will remain open if Pacific receives the requested interLATA authority.[235] Over the past years, Pacific has engaged in numerous and repeated violations of state and federal law and regulations and has blocked lawful efforts by regulators to oversee and monitor its conduct. The size and nature of these violations provide no reason to have any confidence in Pacific's paper promises of future compliance with the law.

1. Pacific's Violations Of CPUC Accounting Rules And Audit Obstruction.

As demonstrated above, Pacific has just this year been found by auditors the CPUC retained to have violated CPUC accounting rules, and has obstructed efforts to audit its books and records. Besides precluding a finding of section 272 compliance, these problems also compel the conclusion that granting Pacific in-region interLATA authority at this time would not be in the public interest. For example, there can be no confidence that Pacific will voluntarily comply with the requirements of the Act if granted their request for interLATA authority when, at the same time, Pacific has been found to have violated CPUC accounting rules to such an extent that it understated its regulated operating income by approximately $2 billion over a three year period, and that through this conduct avoided paying refunds to California customers totaling approximately $350 million. *See* Pacific

[235] *See Michigan 271 Order* ¶¶ 391, 397; *SBC Texas 271 Order* ¶ 431. While the Commission has stated that it "will not withhold Section 271 authorization on the basis of isolated instances of allegedly unfair dealing or discrimination," it has indicated that it will take such action where "a pattern of discriminatory conduct" exists that undermines its confidence that the relevant "local market is open to competition and will remain so" after the grant of Section 271 authority. *SBC Texas 271 Order* ¶ 431.

Audit Report, 1-1 – 1-2. This Pacific Audit Report (which awaits review by the CPUC), casts a long shadow over Pacific's entire application, especially in light of the well-documented accounting problems in the telecommunications industry this year.[236]

The Audit Report's findings of improper subsidization pose an even more direct threat to competition. Such subsidization by Pacific of SBC affiliates (using Pacific's income from the regulated local market, which it dominates, to subsidize affiliates in competitive markets), impairs competition by giving affiliates unfair competitive advantages and creating the opportunity for illegal price squeezes. As discussed above, the Audit Report identified numerous instances of improper cross subsidies, but two egregious examples stick out. First, the Audit Report uncovered that Pacific began in 2000 paying an annual fee of over $400 million to SBC for Pacific's use of the SBC name. If continued, these payments would now total over $1 *billion*. This amounts to a blatant and improper subsidy of SBCS. It is ludicrous to think the SBC brand has any value to Pacific in California. Instead, it is SBCS, the long distance affiliate, that most obviously gains value through Pacific's use of the SBC brand. By seeing the SBC brand associated with their longtime local service provider Pacific, California consumers inevitably become more familiar with SBC, increasing SBC's brand value and making them more likely to be receptive to new interLATA service from an SBC affiliate using the same SBC name and logo.

Second, the Pacific Audit Report determined that Pacific had transferred its CPNI for use by SBC affiliates without receiving any compensation.[237] Again, this amounts to a substantial improper subsidy of the SBCS. The Pacific CPNI, developed over decades and funded by its regulated telephone customers, is the only complete database of customers in the California

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[236] *Cf.* Order, *In the Matter of Qwest Communcations Int'l Consolidated Application Provision of In-Region, InterLATA Services in Colorado*, et al., WC Docket Nos. 02-148, 02-189 (rel. Sept. 10, 2002) (granting Qwest's withdrawal of its section 271 application for nine states after Qwest was forced to admit that its financial statements had been misstated and were not GAAP compliant).

telecommunications market areas.[238] Access to such CPNI provides SBCS an unmatched competitive advantage in marketing its interLATA services once it receives authority under section 271.[239]

Besides such staggering underreporting of operating income and improper cross-subsidization (in violation of state regulations), Pacific also has been found to have obstructed the very audit that reached these conclusions. Thus, the Audit Report concludes that "Pacific imposed restrictions on the data it considered to be relevant and within the audit scope," and recounts numerous instances where Pacific's "data responses were incomplete or not responsive" or simply went unanswered.[240] As a result of such obstructions and refusals, the auditors were prevented "from obtaining sufficient data to develop conclusions in some areas," and the audit's completion was delayed by six months.[241] Given Pacific's refusal to cooperate with, and active obstruction of, a CPUC-required audit, no finding is justified that Pacific will become more receptive to regulatory oversight if interLATA authority is granted.

Finally, because the CPUC had closed the record to new evidence in its section 271 proceeding in September 2001, none of the Pacific Audit Report findings was a part of the record considered by the CPUC when it reached its decision on Pacific's application. At the very least, therefore, these serious findings of unlawful conduct by Pacific must have a full airing before the CPUC before any determination reasonably can be made that Pacific's entrance into the interLATA

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[237] Pacific Audit Report, S12-1 (June 20, 2002).

[238] *Id.* S12-6 – 12-7.

[239] Nor is this anticompetitive abuse of CPNI by PacBell an isolated occurrence. As the CPUC recognized in its decision, CPUC Decision, 254-55, PacBell and its then section 272 affiliate, PBCom, were permanently enjoined by a federal district court from misappropriating AT&T's, MCI's, and Sprint's billing information for their own marketing purposes. *See* Order, *AT&T Communications of California v. Pacific Bell*, Consolidated Action No. C 96-1691 CRB (N.D. Ca. Apr. 6, 1998) (Attachment 3, hereto). In imposing this injunction, the district court found that "Pacific has misappropriated [AT&T's, MCI's and Sprint's] valuable information to target [AT&T's, MCI's and Sprint's] customers. By using the electronic billing information in a potentially competitive manner, [PacBell and PBCom] have misappropriated [AT&T's, MCI's and Sprint's] trade secrets." *Id.* at 12. This action later was settled following a remand by the Ninth Circuit for further hearings. *See CPUC 2002 271 Decision* at 255.

[240] Pacific Audit Report, 2-4.

[241] *Id.* at 1-4.

market is consistent with the public interest. Pacific's delayed compliance, or outright refusals to comply, with auditors' requests cannot be allowed to serve their apparent purpose; that is, to so delay the auditors' report so that the information cannot properly be evaluated by the CPUC in the context of Pacific's current application. Granting Pacific's application in the face of these grave concerns about the integrity of the approval process cannot be in the public interest.

2. Pacific's $27 Million Fine For Defrauding DSL Consumers And Misleading The CPUC.

Just two weeks ago, on September 27, 2002, a decision of a CPUC Administrative Law Judge approved a record-setting $27 million penalty against Pacific and certain affiliates for having charged customers for DSL service that was either never installed or had never worked properly, and for its misleading advertising and aggressive collection efforts concerning this service.[242] Perhaps most significant to Pacific's current application, Pacific also was found to have failed to maintain or report to the CPUC accurate information concerning the huge number of complaints it had received concerning its DSL service. CPUC ALJ Decision (DSL Complaint), 12-13. For example, although Pacific and its affiliates had received an estimated 30,000 to 70,000 DSL-related complaints during the period from January 2000 to the present, *id.* at 9, Pacific initially reported to the CPUC that *no* complaints had been received by affiliates providing the DSL service for all of 2001, and submitted a complaint report for the first quarter of 2002 reporting a total of only 8 complaints during that period.[243] As part of its settlement of this matter, Pacific was forced to acknowledge that its "failure to report all consumer complaints as the Commission required [was] unacceptable."[244]

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[242] The Utility Consumers' Action Network v. Pacific Bell Telephone Company, Case 02-01-007, Presiding Officer's Decision (Sept. 27, 2002) ("CPUC ALJ Decision (DSL Complaint)") (Attachment 4, hereto).

[243] *See* Settlement Agreement between Pacific Bell Telephone Company, et al. and Utility Consumers' Action Network, I.02-01-024, C.02-01-007, ¶¶ 10, 37-38 (July 3, 2002) ("DSL Settlement Agreement") (Attachment 5, hereto).

[244] CPUC ALJ Decision (DSL Complaint), at 14.

This very recent violation by Pacific of basic reporting obligations under CPUC regulations – whether intentional or because of inadequate controls – further undermines any confidence in Pacific's pledges to comply with it numerous reporting obligations under the Act, and confirms the CPUC's decision that Pacific's entrance into the interLATA market at this time would not be in the public interest.

3. Pacific's $25 Million Fine For Misleading Marketing Tactics In Violation Of State Regulations.

As discussed further below, a significant element of the CPUC's conclusion that Pacific's entrance into the interLATA would not promote the public interest was its concern that Pacific could quickly leverage its market power in the local exchange market because of its substantial marketing advantages.[245] The concern that Pacific will attempt to leverage its local market power to gain anticompetitive advantages in the interLATA market through improper marketing tactics (despite existing regulatory restrictions) is well founded. A recent CPUC decision found that Pacific engaged in improper and misleading marketing efforts, and imposed a then-record fine against Pacific of $25.55 million.

Specifically, on September 20, 2001, the CPUC imposed a fine of $25.55 million on Pacific for marketing abuses, which included its systematic failure, in violation of California regulations, to inform consumers accurately about lower cost service options.[246] The CPUC imposed a substantial fine in part because "[t]he marketing practices in which Pacific engaged constitute[d] serious violations of the Public Utilities Code," and in part because "[t]he seriousness of Pacific's wrongful conduct [was] compounded by the fact that Pacific engaged in similar conduct that [the CPUC had]

[245] *See CPUC 2002 271 Decision*, at 256-258.

[246] The Utility Consumers' Action Network v. Pacific Bell (U 1001 C), Case 98-04-004, Final Opinion on Pacific Bell's Marketing Practices and Strategies, D.01-09-058 (Sept. 20, 2001) ("CPUC Marketing Practices Decision") (Attachment 6, hereto).

declared unlawful in [a] 1986 market abuse case."[247] The CPUC explained that while it "had hoped that the sanctions imposed in the 1986 marketing case would have permanently deterred Pacific's abusive marketing practices," it concluded that "[s]adly, they did not," and that Pacific instead chose "to resume unlawful practices to the detriment of its customers, both in terms of time and money."[248] The CPUC further expressed that it was "particularly disturbed that Pacific included in its targeted customers those who can ill afford to pay any more than necessary for phone service, and customers whose primary language is not English."[249]

This recent finding that Pacific had engaged in serious marketing abuses in violation of CPUC regulations thus further supports the CPUC's conclusion that allowing Pacific to enter the interLATA market at this time would not be consistent with the public interest.

4. Pacific's Defiance Of The CPUC's Joint Marketing Restrictions.

As discussed above, the CPUC has set forth certain joint marketing rules both to deter the type of improper marketing tactics for which Pacific has previously (and repeatedly) been sanctioned and to protect California consumers from unwanted and confusing marketing pitches. CPUC Decision, at 256-57. Although these CPUC marketing rules are fully consistent with section 272(g) and this Commission's orders, Pacific has suggested that these CPUC guidelines are barred by federal law, and has provided no evidence that it will comply with these rules (or even committed to comply) should it be granted interLATA authority.[250]

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[247] CPUC Marketing Practices Decision, 9.4. In the referenced 1986 marketing abuse case, which also concluded that PacBell had violated state law through similar abusive marketing practices, PacBell was ordered to pay a fine of $16.5 million. CPUC Marketing Practices Decision, 9.4.

[248] *Id.*

[249] *Id.*

[250] *See CPUC 2002 2721 Decision*, at 267; Pacific Bell Telephone Company's (U 1001C) Reply To The Opposition Filings On Public Utilities Code Section 709.2 Requirements, CPUC, Rulemaking on the Commission's Own Motion To Govern Open Access To Bottleneck Services and Establish a Framework for Network Development of Dominant Carrier Networks, R.93-04-003, at 32 (Sept. 13, 2001); Yohe Aff., ¶ 46.

No finding can be made that granting Pacific interLATA authority is consistent with the public interest while Pacific defies the CPUC in this manner. This is especially true given the CPUC's finding that its marketing rules are tremendously important to deter the most egregious leveraging of Pacific's local market power to garner unfair advantages in the interLATA market. These CPUC rules, for example, require that Pacific complete the service-related request during inbound calls before engaging in joint marketing of its affiliates services.[251] In addition, when inquiring about the customers selection of a long distance provider, Pacific must first determine if the customer has already selected a provider before marketing its affiliate's services and must respect customers' choices and not try to get them to change their selection.[252]

The CPUC rules are fully consistent with section 272(g) and the Commission's prior orders on joint marketing.[253] It thus would be contrary to the public interest to grant Pacific interLATA authority while it defies the CPUC and refuses to abide by these joint marketing rules.

In sum, Pacific's past anticompetitive and illegal activities in California reflect a pattern of "discriminatory and other anticompetitive conduct" that precludes any finding that Pacific's local market is open to competition and will remain open if it receives the requested interLATA authority.[254]

C. Pacific's Misconduct In Its Role Of PIC Administrator Further Illustrates Why InterLATA Authorization Is Not In The Public Interest.

Pacific currently has the role as the Preferred Interexchange Carrier (PIC) administrator in California. Significantly, as AT&T showed in a separate complaint brought against Pacific before the CPUC and in the CPUC section 271 proceeding, the number of intraLATA toll PIC disputes rose

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[251] *CPUC 2002 271 Decision*, at 257.
[252] *Id.* at 251, 257-58.
[253] *See South Carolina 271 Order* ¶ 239; *Louisiana 271 Order* ¶ 357.
[254] *See Michigan 271 Order* ¶¶ 391, 397; *Texas 271 Order* ¶ 431.

significantly once intraLATA equal access was implemented in California.[255] In fact, the levels of PIC dispute charges issued by Pacific as PIC administrator were many times greater than AT&T had experienced from any other ILEC. As a result of AT&T's complaint, the CPUC launched an inquiry into Pacific's handling of PIC disputes. This review concluded, in part, that "Pacific had improperly billed AT&T for customers that switched to AT&T and then returned to Pacific under Pacific's winback program, and that Pacific's coding of complaints in its billing system may be inaccurate."[256] The CPUC went on to determine that Pacific's "process of tracking and billing" PIC disputes were "flawed," and, "at a minimum, contributed to customer confusion."[257]

Given this evidence, the CPUC has questioned "the appropriateness of the Commission's enforcement staff's continued reliance on Pacific's dispute reports," as well as "the appropriateness of relying on Pacific to determine a PIC/LPIC dispute, and to assess a slamming switching fee onto competing interexchange carriers."[258] Recognizing the conflict between "Pacific's duty to administer PIC changes in a competitively neutral way and its interest in winning customers," the CPUC concluded that "a substantial possibility of harm to the intrastate long distance telephone market exists from Pacific's continuing role as the PIC administrator."[259] The CPUC reasoned that, in light of the evidence in the record, "absent competitively neutral and nondiscriminatory PIC dispute reporting and administration, there is a possibility that the intrastate interexchange telecommunications market will be harmed through increasing carrier conflicts."

Pacific dismisses these findings, noting that the Commission has granted prior section 272 applications despite the fact that the relevant RBOC was to continue as PIC administrator, and baldly

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[255] *CPUC 2002 271 Decision,* at 260.

[256] Opinion on Slamming Complaints, *AT&T Comm. of Calif.* v. *Pacific Bell Telephone Co.*, Case No. 99-12-029, D.02-10-006, at 5 (Oct. 3, 2002)).

[257] *Id.* at 5-6, 9.

[258] *CPUC 2002 271 Decision*, at 260.

asserting that there is "nothing in the record to call into question Pacific's actual performance as the PIC administrator." In so doing, Pacific refuses to acknowledge, let alone refute, AT&T's showing (credited by the CPUC) that the level of PIC dispute charges in California are many times what AT&T has experienced with other ILECs. Instead, as the CPUC found, Pacific has "failed to offer any assurance that it would perform its LPIC role with any safeguards of neutrality or sensitivity to competitor concerns."[260] Although the CPUC recognized that a "neutral third party [PIC] administrator may be necessary" if Pacific were to enter the interLATA market,[261] it determined that the prudent course was to initiate an investigation into "the costs and feasibility of selecting a competitively neutral third-party PIC administrator."[262]

The record in California thus shows that Pacific's continuing role as PIC administrator raises significant risks of anticompetitive abuses if Pacific is granted interLATA authority. The CPUC should be permitted to determine whether non-structural safeguards can protect against continued abuses by Pacific of its PIC administrator role, or whether (as AT&T believes) a neutral third party PIC administrator is the only option in California, given Pacific's uniquely poor performance to date, that is consistent with a competitive telecommunications market.

D. Pacific Maintains Monopoly Power Over Residential Service.

Given the pattern of Pacific's noncompliance with the Act and its efforts to stall or prevent competition, it is not surprising that Pacific has to date been able to retain monopoly power over residential service in California. In reviewing actual competition in the local market, the Commission reviews the extent to which new entrants "are actually offering" local service to both

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[259] *Id.* at 301.
[260] *Id.* at 259.
[261] *Id.* at 263.
[262] *Id.* at 264.

business and residential customers through each of the three means offered by the Act.[263] The "Act contemplates three paths of entry into the local market – the construction of new networks, the use of unbundled elements of the incumbent's network, and resale."[264] As the Commission has recognized, its public interest analysis "must include an assessment of whether all procompetitive entry strategies are available to new entrants."[265] And, as the Commission explained in the *Michigan 271 Order*, "[t]he most probative evidence that all entry strategies are available would be that new entrants *are actually offering* competitive local telecommunications services to different classes of customers (residential and business) through a variety of arrangements (that is, through resale, unbundled elements, interconnection with the incumbent's network, or some combination thereof), in different geographic regions (urban, suburban, and rural) in the relevant state, and at different scales of operation (small and large)."[266] In subsequent applications, the Commission has repeatedly considered the degree to which competitors have actually succeeded in offering local telecommunications services using the different entry strategies prescribed by the Act.[267]

Here, a recently published report on behalf of the CPUC concludes that that Pacific continues to dominate the local exchange and intraLATA toll markets, with competition only beginning to take hold. Thus, the report concludes that "[c]ompetition in the local market is currently very limited," with data showing that ILECs hold "dominant positions" statewide, controlling "between 94 and 96.4 percent of local phone lines."[268]

The ILECs California local market dominance is even more apparent when looking at revenue figures. ILECs local market revenues as a percentage of total local market revenues have ranged

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[263] *Michigan 271 Order* ¶ 391.
[264] *Id.* ¶ 96.
[265] *Id.* ¶ 387.
[266] *Id.* ¶ 391 (emphasis added).
[267] *See, e.g., New York 271 Order* ¶¶ 13-14; *Texas 271 Order* ¶¶ 5-6.

between 98.7% and 99.0 % during the period from 1998 through 2000.[269] CLEC's share of local telephone revenue thus has ranged from .96 % to 1.26 % during this same period.[270] Equally striking is that there has not been a substantial change in these percentages during years studied in the CPUC competition report, or a noticeable trend toward higher CLEC local market revenues. In fact, local market revenues for CLECs dropped from 1998 to 1999 as a percentage of total revenue.[271] And the percentage of total revenue for CLECs from 1998 (1.062 %) and 2000 (1.268%) does not reflect any dramatic improvement, reflecting what the CPUC described as the "anemic" development of local competition in California.[272]

To be sure, the CPUC's recent lowering of UNE rates in May 2002, by making competitive entry by CLECs more viable, undoubtedly will improve these figures for the current year. But even if such improvement were dramatic they would pale in comparison to the rapid success experienced by ILECs in obtaining substantial shares of the interLATA markets shortly after receiving section 271 relief. Thus, SBC recently predicted that it anticipates achieving an astounding 30% market share within one year of its entry into the interLATA market, and has predicted that it will capture market shares of 60-70% within just three to four years.[273]

These statistics make apparent that allowing Pacific into the interLATA market at a time when CLECs are still attempting to obtain a significant and sustainable presence in the local market

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[268] The Status of Telecommunications Competition in California, CPUC, at 1.1 (June 5, 2002) (Attachment 7, hereto).
[269] *Id.* at 3.12-3.13.
[270] *Id.*
[271] *Id.*
[272] *CPUC 2002 271 Decision*, at 264. This evidence of Pacific's continuing market dominance is of special concern given that less than two years ago a jury found Pacific guilty of unlawful monopolization of the local exchange market under section 2 of the Sherman Act (15 U.S.C. § 2). See CPUC Decision, at 247. The action had been instituted by CLEC CalTech International Telecom, who established that Pacific's wholly inadequate processing of customer migration orders had effectively barred CalTech from competing with PacBell. Although this case ultimately settled before judgment was entered against Pacific, the jury's verdict is stark evidence of Pacific's willingness and ability to maintain its monopoly power in the local exchange market.

risks destroying the CLECs' recent competitive gains. Pacific will be able to market and provide bundled local and interLATA services to a degree CLECs will be unable to match, leveraging its local market dominance into the interLATA market. One only need take SBC at its word and envision a market after only one year of section 271 approval, with Pacific holding a 30% interLATA market share and a 90+% local market share, to recognize the likelihood that Pacific's current entry will undermine, not serve, telecommunications competition in California.

E. Pacific's Entry Into The InterLATA Market Will Not Reduce Prices For California Consumers In That Market.

Pacific's current entry into the interLATA market not only would undermine the burgeoning competition in the local exchange market, but would offer no countervailing benefits in the interLATA market for California consumers. Bear, Stearns & Co. reports that SBC Management, in a meeting on September 10, 2002, indicated that there would be no "price war" in consumer long distance, and instead that "RBOC pricing is in-line or higher than the IXCs'."[274] Yet, as noted above, despite the lack of anticipated price competition in the interLATA markets, SBC Management reported it "assumes that it can achieve 30% market share 12 months after entering a new market and is targeting a long run (3-4 years) penetration rate in the 60%-70% range."[275]

In contrast to SBC's repeated (and unsupported) claims of the benefits arising from its entry into the California interLATA market, SBC's report to Bear, Stearns shows that its entry into the California market will not benefit California consumers by driving down interLATA rates. Moreover, SBC's remarkable predictions of substantial market shares within a year of entering the interLATA market (and interLATA market dominance within 3-4 years), despite the absence of price competition, starkly shows SBC's expected ability to leverage its market power in the local exchange

[273] Bear, Stearns & Co. Inc., Equity Research, *Highlights From Meeting With SBC Management* (Sept. 10, 2002) (Attachment 1, hereto).
[274] *Id.*

market quickly to gain dominance in the interLATA market. These SBC predictions thus strongly support the CPUC's expressed concern that Pacific's long distance affiliate's "potentially swift dominance of the intrastate interexchange telephone market," which "could detrimentally impact competition in that section."[276] Granting Pacific section 271 at the present time, therefore, not only threatens the further development of local competition, but offers no prospect of benefits to California long distance consumers.

F. Pacific's Performance Incentive Plan Is Inadequate

Finally, Pacific's application may not be found in the public interest because Pacific has yet to establish a performance incentive plan that will provide meaningful remedies in the event that Pacific fails to meet its performance obligations. This Commission has made clear that, when an applicant relies on a performance monitoring and enforcement plan to support its application, it will review the contours of that plan to assess whether it provides sufficient incentives for compliance with Section 271. As the Commission has stated:

> Where, as here, a BOC relies on performance monitoring and enforcement mechanisms to provide assurance that it will continue to maintain market-opening performance after receiving Section 271 authorization, we will review the mechanisms involved to ensure that they are likely to perform as promised. While the details of such mechanisms developed at the state level may vary widely, we believe that we should examine certain key aspects of these plans to determine whether they fall within a zone of reasonableness, and are likely to provide incentives that are sufficient to foster post-entry checklist compliance.[277]

Moreover, the Commission has identified certain key elements in a performance monitoring and enforcement plan that will buttress a showing "that markets will remain open after grant of the

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[275] *Id.*

[276] CPUC 2002 271 Decision at 261.

[277] *New York 271 Order,* ¶ 433. *See also Texas 271 Order* ¶ 423; *Kansas/Oklahoma 271 Order* ¶ 273.

application."[278] Thus, in the *New York 271 Order*, the Commission found that the New York performance assurance plan would serve as an effective mechanism for ensuring future Section 271 compliance because it contained the following characteristics:

> potential liability that provides a meaningful and significant incentive to comply with the designated performance standards;
>
> clearly-articulated, pre-determined measures and standards, which encompass a comprehensive range of carrier-to-carrier performance;
>
> a reasonable structure that is designed to detect and sanction poor performance when it occurs;
>
> a self-executing mechanism that does not leave the door open unreasonably to litigation and appeal; and
>
> reasonable assurances that the reported data is accurate.[279]

Similarly, in its subsequent decisions reviewing Section 271 applications, the FCC has evaluated each performance remedy plan at issue based upon these same characteristics.[280] Pacific's performance monitoring and enforcement mechanisms do not and cannot satisfy these criteria.

No anti-backsliding plan can be effective unless it is based upon a system of comprehensive performance measurements producing accurate and reliable performance results that are coupled with enforcement mechanisms that can effectively deter Pacific from engaging in anticompetitive conduct. These conditions do not presently exist in California.

Because Pacific's performance data which serve as the springboard for remedies payments are unreliable, they fatally compromise the efficacy of any performance incentive plan. Even if Pacific's data were accurate, reliable and comprehensive – and they are not – the structural defects in Pacific's

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[278] *Id.* ¶ 423.

[279] *Id.* ¶ 433.

[280] *See Texas 271 Order* ¶¶ 424-429; *Kansas/Oklahoma 271 Order* ¶¶ 273-278; *Massachusetts 271 Order* ¶¶ 240-247; *Connecticut 271 Order* ¶¶ 76, 77.

remedy plan render them ineffective tools to deter anticompetitive conduct after any section 271 entry.

In this regard, the California performance remedy plan provides no "meaningful" or significant "incentive[s]" to assure that Pacific will comply with parity and benchmark performance standards in the wake of Section 271 entry.[281] The very structure of the California performance incentive plan – which includes a curvilinear payment mechanism purportedly designed to mitigate the risk of Type I error (*i.e.,* an erroneous finding of a lack of parity) – is ill-conceived and results in nominal remedy payments that cannot possibly serve as sufficient incentives to encourage statutory compliance.[282]

In this regard, in its Decision adopting the performance incentive plan, the CPUC expressly declined to adopt Pacific's proposed mitigation provisions – provisions which Pacific contended were essential to guard against the risk of Type I error. In doing so, the CPUC acknowledged that "[t]here is insufficient information in the record of this proceeding to appropriately apply a correction for random variation because each type of test will have a different failure rate at parity and non-parity levels."[283] The CPUC also found that mitigation provisions which excuse performance failures occurring at certain levels could result in a BOC "gaming"[284] the process and targeting key measures for substandard performance. Additionally, the CPUC recognized that "[i]n every instance where an identified failure is forgiven, [pursuant to mitigation provisions] performance to a CLEC's customer is worse than performance to the ILEC's customers, [and that] [w]hile at a theoretical level, some of

[281] *New York 271 Order* ¶ 433.
[282] Toomey/Walker/Kalb Decl. ¶¶ 80-91.
[283] CPUC Decision 02-03-023, March 6, 2002, Findings of Fact No. 53.
[284] *Id.* at 33.

these identifications may be Type I errors, we cannot ignore the fact that the inferior performance disadvantages the CLEC."[285]

In that same Decision, the CPUC suggested that the mitigation provisions proposed by Pacific were unnecessary because the critical alpha value in the performance incentive plan provides "considerable protection against random variation:"[286]

> We note that we have already built in considerable protection against random variation. As we discussed in the *Interim Opinion,* even when OSS performance to CLEC customers is worse than performance to ILEC customers, a performance failure is not identified unless the result passes a statistical test. All the instances where CLEC customers receive worse OSS performance are essentially "forgiven" if the statistical test criteria are not met. For example, in December 2001, individual CLECs collectively received poorer service on twenty-eight percent of the sub-measures. Since the 0.10 critical alpha criterion is only met by about eight percent of the results, our "forgiveness" rate is about twenty percent.

Inexplicably, however, the CPUC abandoned this logic in other parts of its Decision and adopted a curvilinear payment structure which is ostensibly designed to mitigate the risk of Type I error:[287]

> Additionally, we note that Pacific will not be without mitigation of an overall Type I error under our plan. Our curvilinear payment structure mitigates Type I error, as it reduces payment rates for lower failure rates. For example, in the performance simulation where four percent of the sub-measures fail, our payment structure only requires payment of about one-tenth of one-percent of Pacific's liability at risk, the payment cap.

The curvilinear payment structure in the performance incentive plan calls for the payment of zero to one percent of the cap for failure rates ranging from zero to five percent, and a payment of one to four percent of the cap for failure rates ranging from five to less than 10 percent.[288] This

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[285] *Id.* at 28.
[286] *Id.* 26, n. 44.
[287] *Id.* at 38.
[288] Toomey/Walker/Kalb Decl. ¶ 87.

payment structure – which purportedly mitigates the risk of Type I error – inappropriately excuses performance failures, generates paltry penalty payments which provide no incentive for Pacific to comply with performance standards, and fails to recognize the risk of Type II error (an erroneous parity finding).

Indeed, Pacific, which had a performance failure rate of 6.7 percent in April 2002, paid $673,390 under the plan – an amount representing .042% of Pacific's monthly net revenue from local exchange.[289] The notion that meager penalty payments – amounting to less than one percent of the cap for a seven percent failure rate – provide sufficient incentives for Pacific to comply with performance standards strains credulity. The monetary consequences of such subpar performance are dwarfed by the benefits that Pacific can enjoy by providing substandard service to its competitors.[290]

Further complicating matters, the performance incentive plan includes additional provisions which permit Pacific to discount the paltry credit amounts generated by the plan when its performance reaches certain performance levels.[291] As a result of all of these defects, Pacific can and will suffer no meaningful financial consequences for substandard, discriminatory performance, and the California performance incentive plan accordingly lacks sufficient incentives to assure statutory compliance after Section 271 entry. For this reason as well, the Commission should conclude that granting Pacific's application at this time is premature and would not be in the public interest.

[289] *Id.* ¶ 91.
[290] *Id.* ¶¶ 89-91.
[291] *Id.* ¶ 90.

CONCLUSION

For the reasons stated above, Pacific's 271 application for California should be denied.

Respectfully submitted,

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October 9, 2002

CERTIFICATE OF SERVICE

I hereby certify that on this 9th day of October, 2002, I caused true and correct copies of the forgoing Comments of AT&T Corp. to be served on all parties by mailing, postage prepaid to their addresses listed on the attached service list.

Dated: October 9, 2002
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/s/ Peter M. Andros
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